



The Real Estate ANALYST

DECEMBER
1943

Roy Wenzlick
Editor

VOLUME XII

A concise easily digested periodic analysis based upon scientific research in real estate fundamentals and trends...Constantly measuring and reporting the basic economic factors responsible for changes in trends and values.....Current Studies..... Surveys.....Forecasts

Copyright 1943 by ROY WENZLICK & CO. - Saint Louis

REAL ESTATE ECONOMISTS, APPRAISERS AND COUNSELORS

TWO YEARS OF WAR AND REAL ESTATE

THE United States is now engaged in its third year of active participation in the war. We have now had sufficient experience under war conditions to be able to forecast with greater confidence the probable developments during the remainder of the war period.

The January 1944 Analyst will be devoted entirely to detailed forecasts of the various factors affecting real estate. This is in accordance with our regular custom for January.

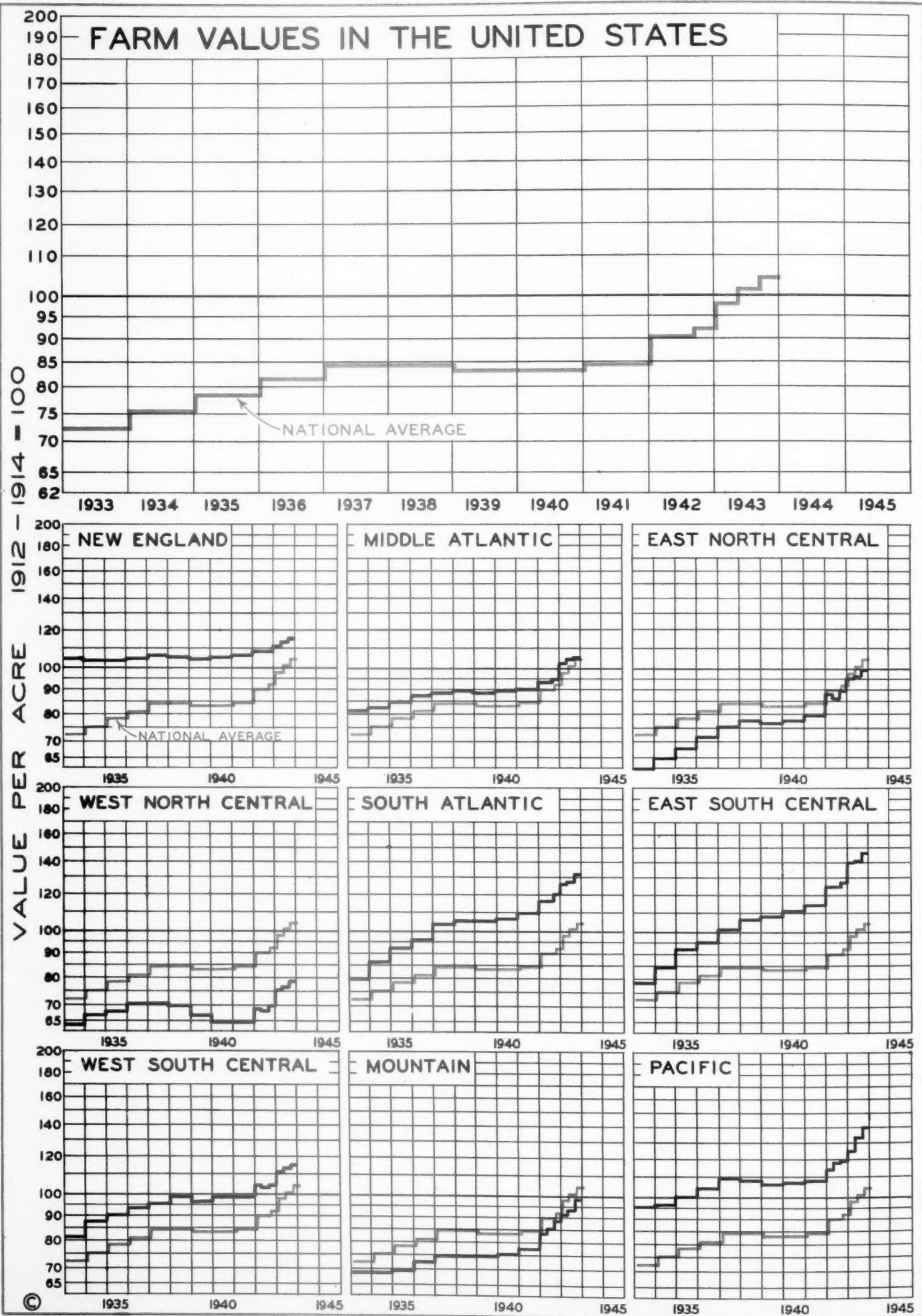
At this point, however, it might be well to review the figures for general real estate activity since we entered the war. In spite of rent control and in spite of the down payment requirement and other limitations on the sale of residential property, real estate sales in November were 27.9% above the long-term computed normal. In December 1941 they were 18.1% above normal and when the war started in Europe in 1939, they were 10.4% below the long-term computed normal.

The rise in sales during the course of the war is the more significant when contrasted with the real estate sales experience during the First World War period. In August 1914 when the First World War started in Europe, our index of sales of real estate in the United States was 20.1% below normal. When we entered the war in April 1917 our index had declined further to 22.0% below normal. In October of 1918 right before the Armistice the index had declined to 38.3% below normal. How can we account for the rising trend during this war in spite of rent control with the declining trend during the First World War when relatively few controls were in force?

The answer is apparently the fact that this war occurred when the basic long-term real estate cycle was in a different position than it was when the First World War occurred. The First World War followed a big real estate boom in the early 1900's. War or no war, a reaction in real estate would have been expected after the excesses of the boom. On the other hand, the present World War started after real estate had been in the doldrums for a great many years and when, war or no war, recovery would have been expected.

This difference in the position of the cycle in both wars has been pointed out repeatedly from the time of the beginning of the war in Europe and we have emphasized again and again in our forecasts that a different trend was to be expected in this war than the one which occurred in the First World War.

Clearly, the actual trends as they have developed have proven these forecasts to be true.



FARM VALUES PER ACRE IN THE UNITED STATES

FARM real estate values continued their upward movement during the four months ending November 1, 1943, with an increase for the country as a whole of about 3% during this period. During the last twelve months, values have risen approximately 13%, which is the highest rate of increase on record, outside of the boom year immediately following the First World War, 1919 to 1920. Values on November 1 were 44% above the 1933 depression low but still 38% under the boom peak of 1920.

The charts to the left show these fluctuations in the values of farms per acre from 1933 through 1943 for the United States as a whole and for each of the various regions. Since 1941 farm values have been rising at a rather rapid rate as a result of the increased demands both at home and abroad for farm products.

The change in farm values per acre has been quite different in the various sections of the country. The nine regional charts each contrast the regional figures with the national average printed in red.

The East South Central district, comprising the States of Kentucky, Tennessee, Alabama and Mississippi, has had the most pronounced rise since 1933 and has reached the highest percentage above the 1912-14 average. The second best showing was made in the South Atlantic area, comprised by the States of Delaware, Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia and Florida.

The Great Plains area, generally thought of as comprising some of the best farming grounds in the United States, has made the poorest showing of any of the regions. This district, known officially as the West North Central district, comprises the States of Minnesota, Iowa, Missouri, North Dakota, South Dakota, Nebraska and Kansas. Not only was practically no progress shown prior to 1941 in this area, but present values are more than 20% below the 1912-14 average.

The values of farms fluctuate more or less in unison with the fluctuations in the prices of agricultural products. In other words, the value of agricultural land is determined almost entirely by the net profit which can be made by using it for the most profitable crops to which it is adapted. In a period when the prices of agricultural products are rising faster than the costs of production, farm lands increase rapidly in price. It seems probable at the present time that this condition will continue until one or two years after the war is over. The peak of farm land prices before occurred in 1919 and 1920 after the close of the First World War.



APARTMENT BONDS RISING RAPIDLY

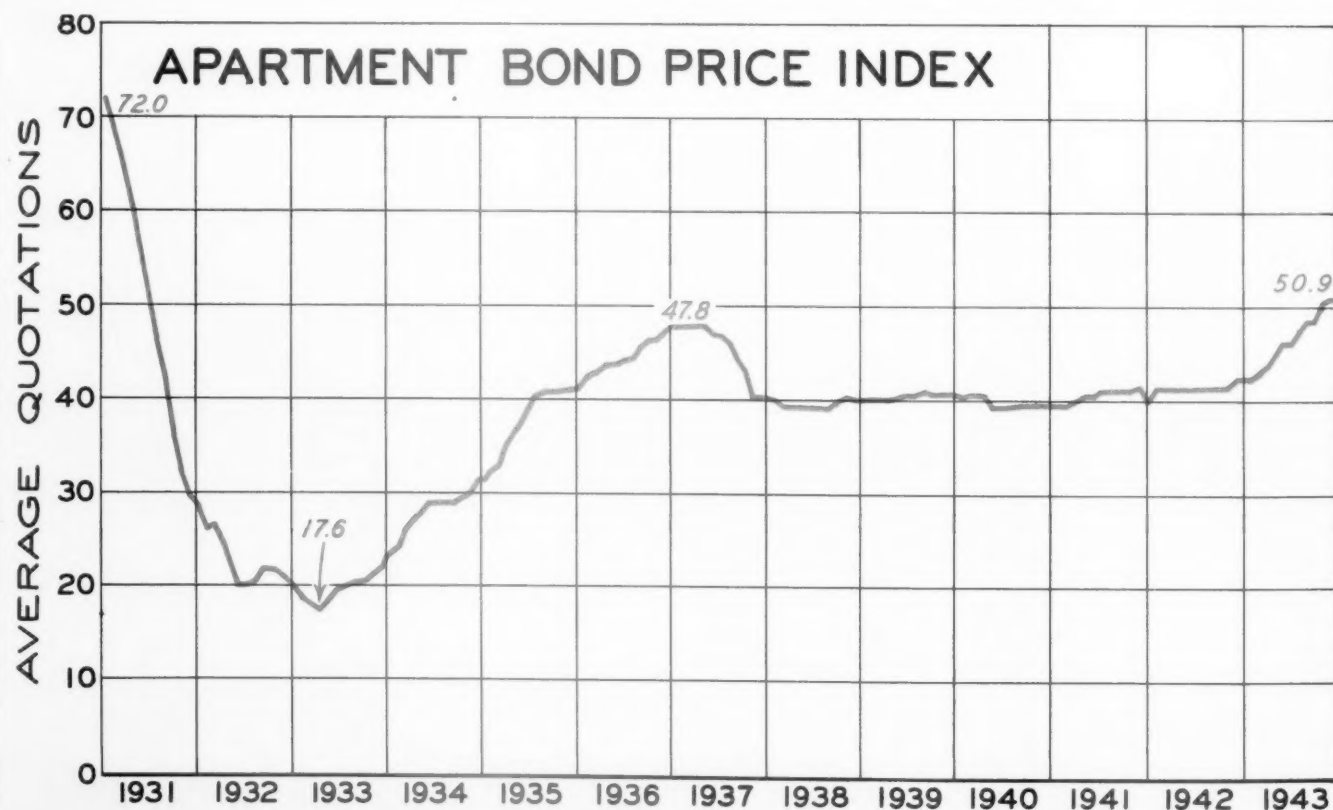
THE index on Apartment Bond Prices, given in table form and charted below, attempts to measure prices since 1931. It was found impossible to carry the index back further as in most cases, prior to 1931, the market for real estate bonds was artificially supported by the underwriting house regardless of the condition of the individual property. The declines in all issues came at the time when the underwriters stopped supporting the market.

The 25 issues selected for this index cover properties in 14 cities. These particular issues were selected because they are sufficiently active to secure regular quotations. Issues with complicated reorganization plans have been avoided.

Apartment bonds have increased by 20% on the average during 1943.

INDEX OF APARTMENT BOND PRICES

	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943
1	72.0	28.0	19.8	23.1	31.7	41.4	47.8	40.2	40.2	40.6	39.8	41.5	42.5
2	69.1	26.3	18.6	24.0	32.7	42.6	47.8	40.2	40.2	41.0	39.8	41.5	43.1
3	66.3	26.8	18.0	26.1	33.7	43.0	47.8	39.4	40.2	41.0	40.0	41.5	43.6
4	63.6	24.7	17.6	26.9	35.0	43.4	47.8	39.4	40.2	41.0	40.8	41.5	44.9
5	59.2	22.2	18.0	28.2	36.8	43.8	47.8	39.4	40.2	39.4	40.8	41.5	46.2
6	54.4	20.0	19.6	29.0	38.7	43.8	46.9	39.4	41.0	37.6	41.2	41.5	46.2
7	50.1	20.0	20.0	29.0	39.5	44.2	46.9	39.4	41.0	38.2	41.2	41.5	47.4
8	45.6	20.6	20.2	29.0	40.6	44.6	46.4	39.4	41.0	39.8	41.4	41.5	48.4
9	41.5	22.0	20.8	29.0	41.0	45.5	44.5	39.4	41.4	39.8	41.4	41.5	48.4
10	36.5	22.0	20.8	29.3	41.0	46.4	43.2	40.2	41.0	39.8	41.4	41.7	50.4
11	32.1	21.7	21.6	29.9	41.0	46.4	40.6	40.6	41.0	39.8	41.8	42.5	50.9
12	29.2	20.8	22.0	31.4	41.4	47.3	40.6	40.2	41.0	39.8	40.5	42.5	50.9



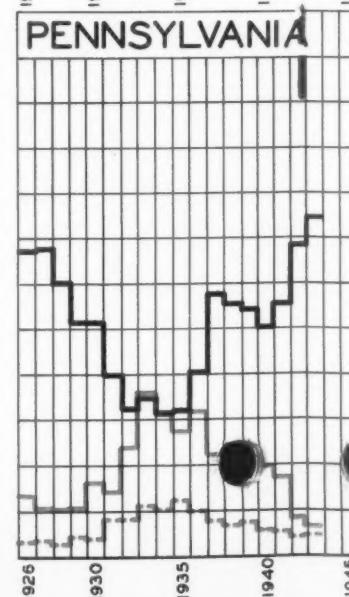
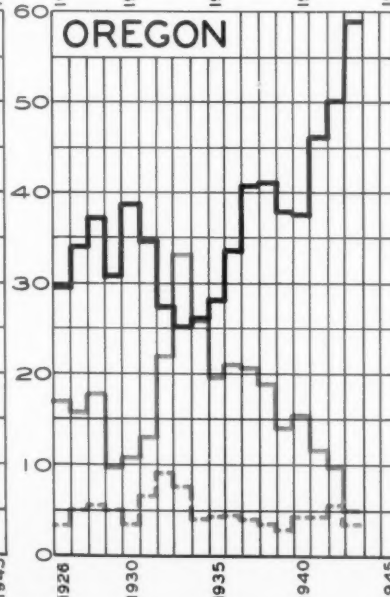
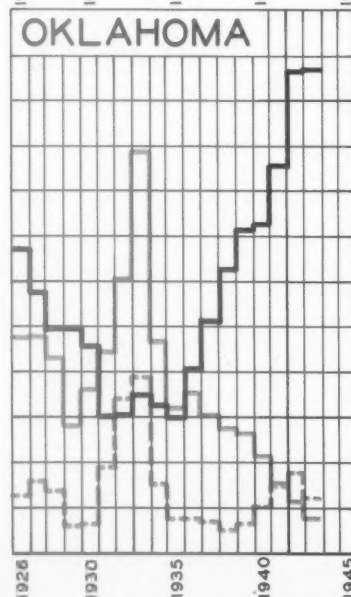
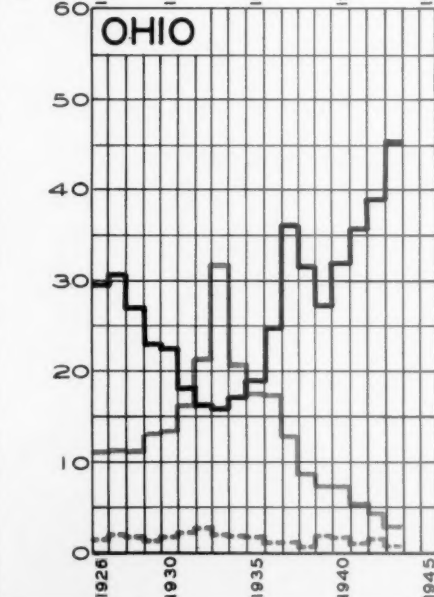
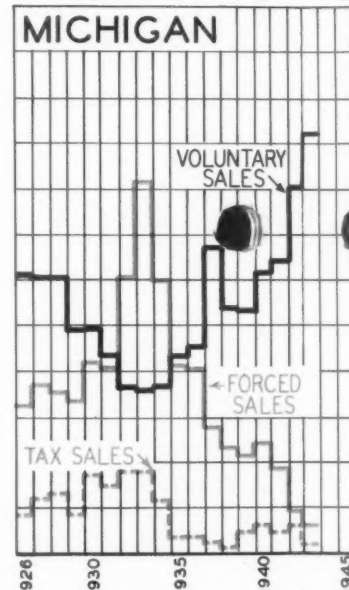
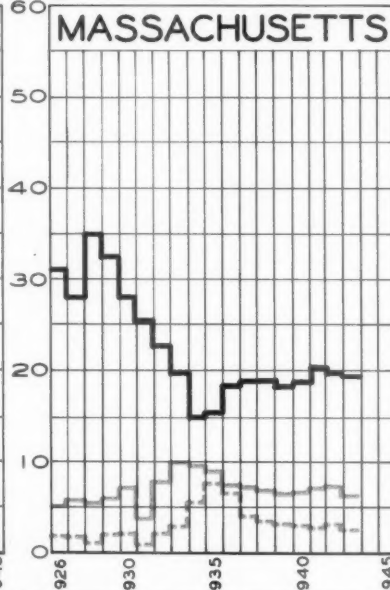
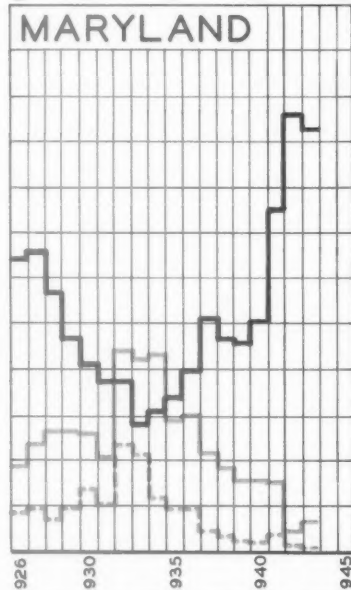
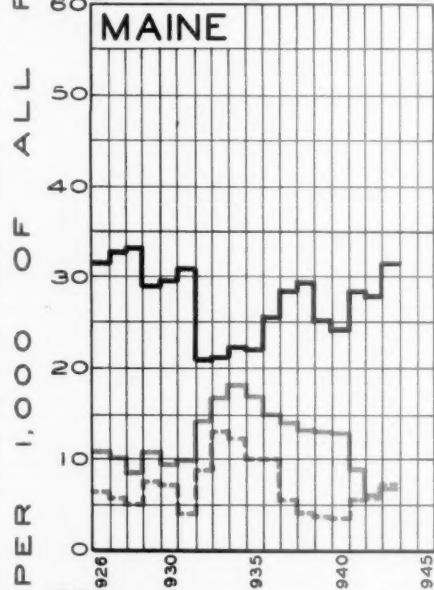
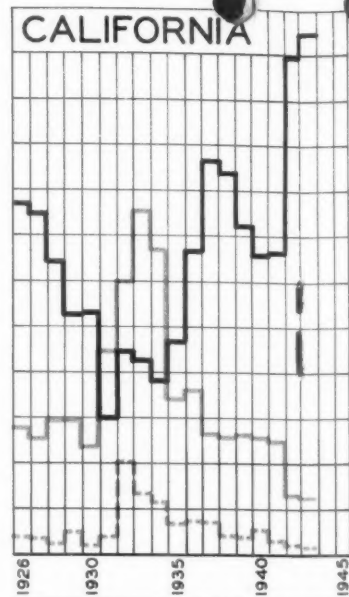
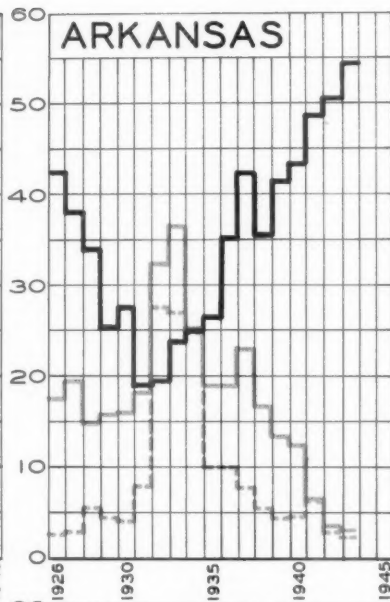
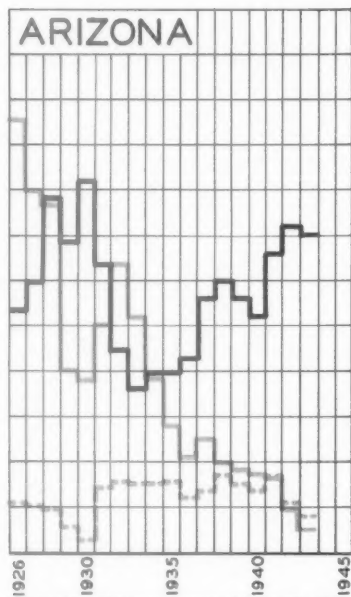
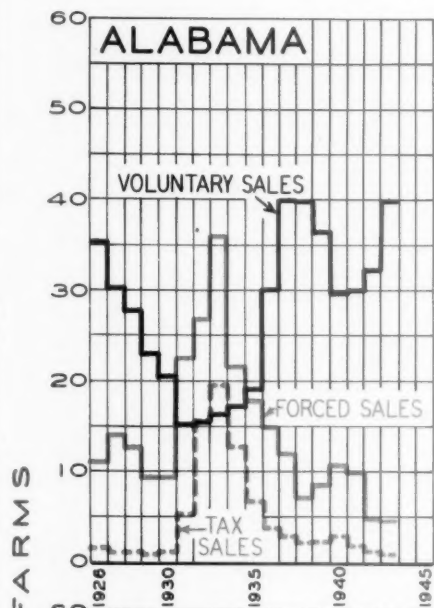
FARM BOOM GAINING MOMENTUM

THE boom in farm land is gaining momentum. Voluntary sales of farms for the year ending March 15, 1943, have reached a new peak exceeding any of the years since 1920. 44.4 farms out of each thousand farms in the United States were sold on a voluntary basis during the twelve months. This is a 6% increase above the comparable period ending in 1942, a 30% increase above the comparable period ending in 1941 and a 60% increase above the average for the years 1935 to 1939.

While the great majority of farm sales are being made in most States to farmers who intend to operate the land themselves, the percentage of sales made to city purchasers buying primarily as a speculation or as a hedge against inflation, is increasing rapidly. The Department of Agriculture has expressed great concern and Secretary Wickard has advocated a special farm land boom profits tax which has been introduced in Congress by Senator Gillette of Iowa. Profits from land acquired after November 1, 1943, and sold within two years would be taxed 90%; the longer the land were held, the lower the tax would be. The bill would apply to all farm lands bought up to three years after the end of the war.

Tax sales of farms declined to a new low in 1943 accounting for only 2.2 farms per thousand of all farms. This compares with 15.3, the peak during the depression. Mortgage foreclosures, bankruptcy, etc., accounted for 4.4, also by far the lowest percentage in recent years comparing with 38.8 in 1933.

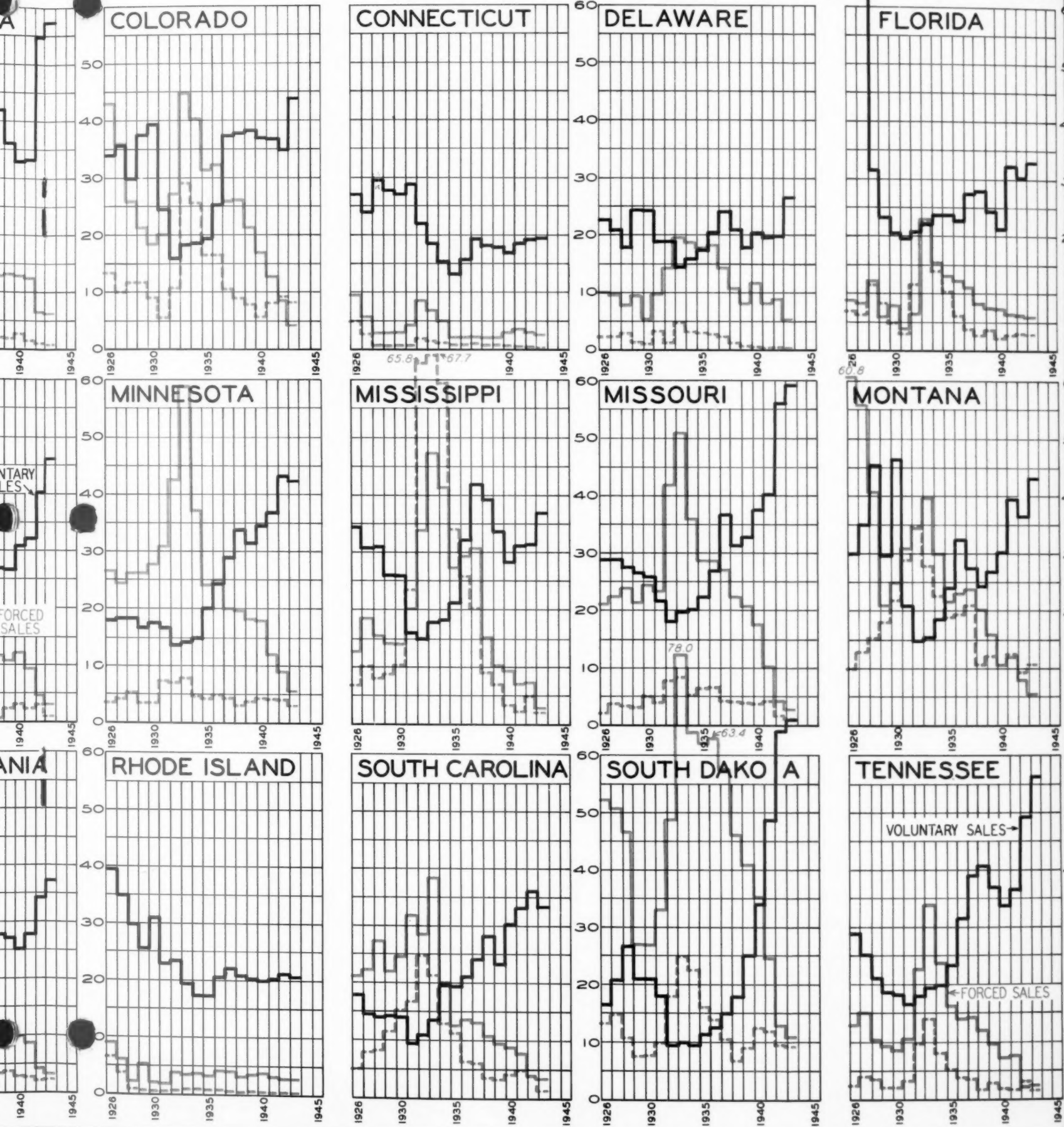




VOLUNTARY AND FORCED SALE

PER 1,000 OF
ROY WENZ

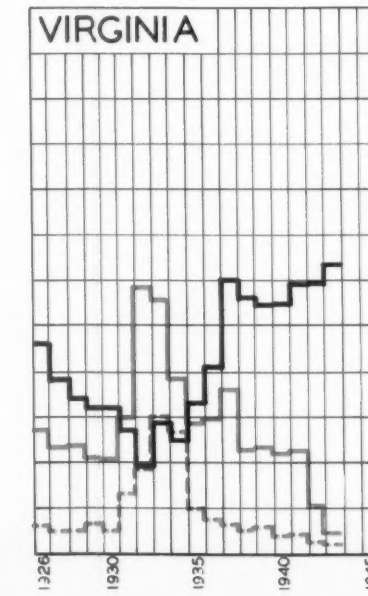
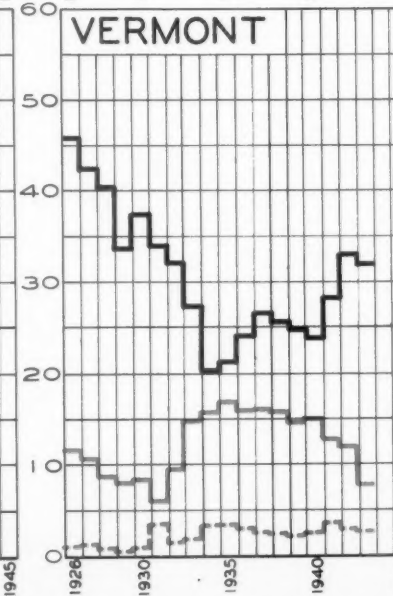
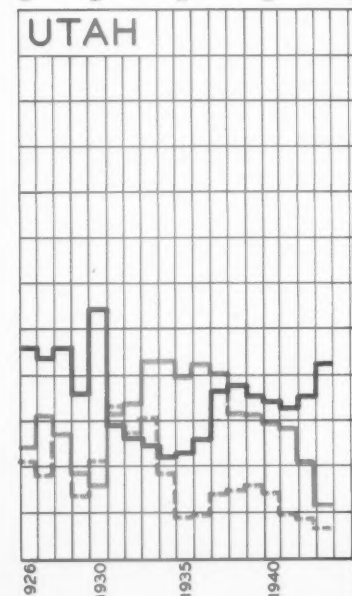
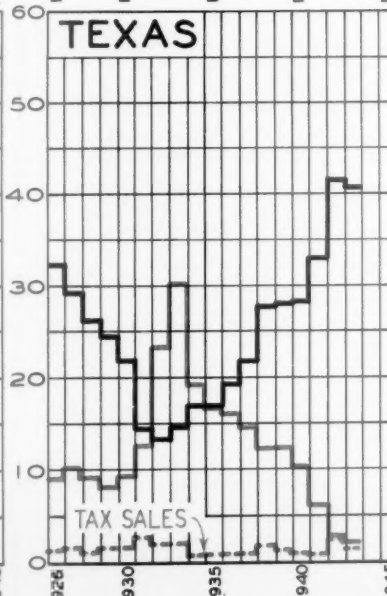
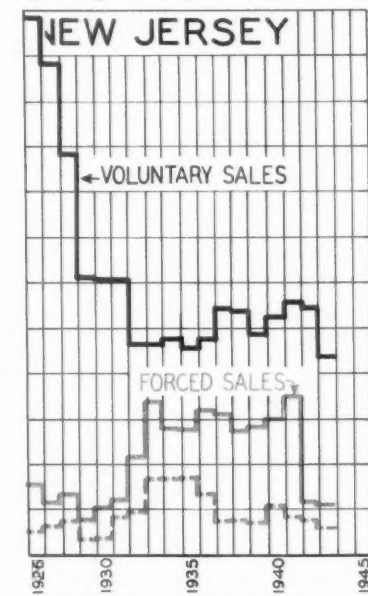
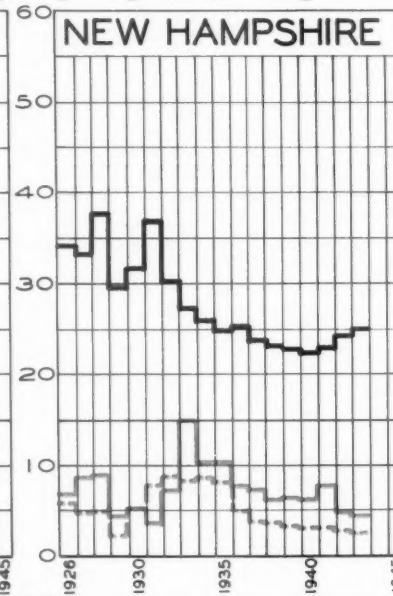
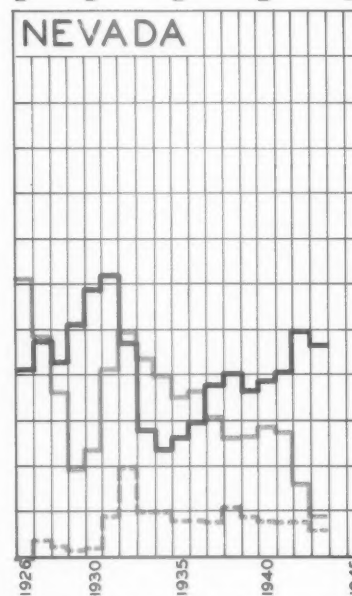
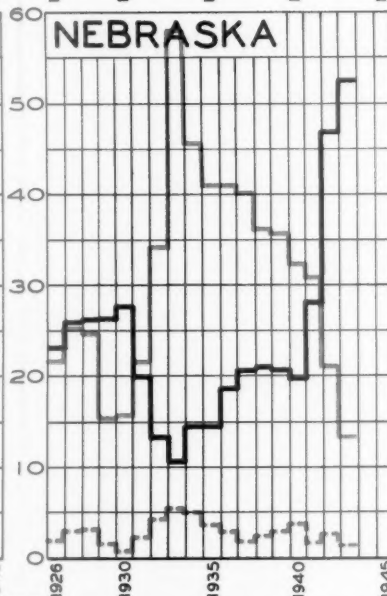
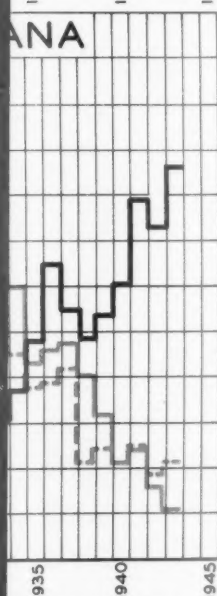
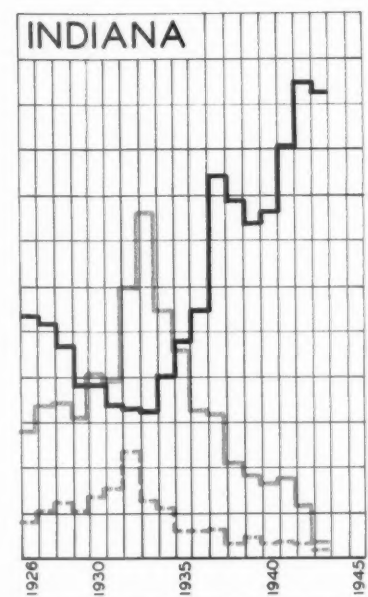
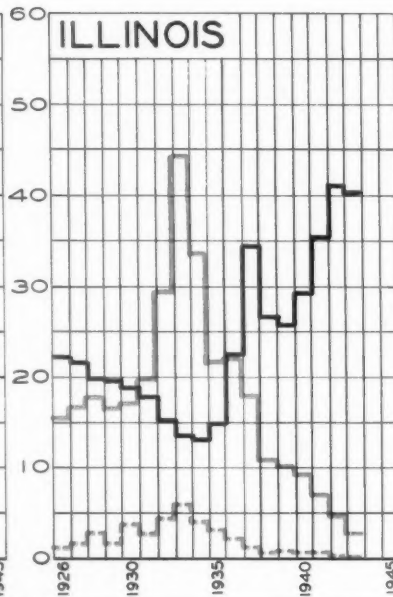
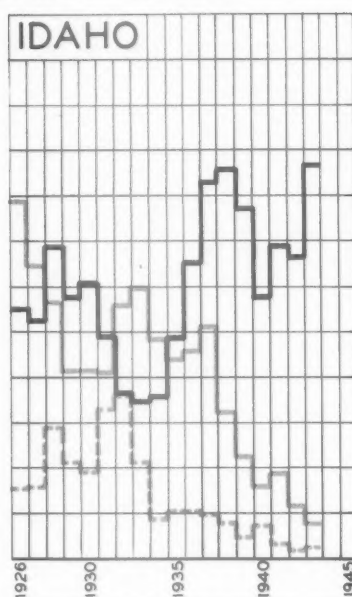
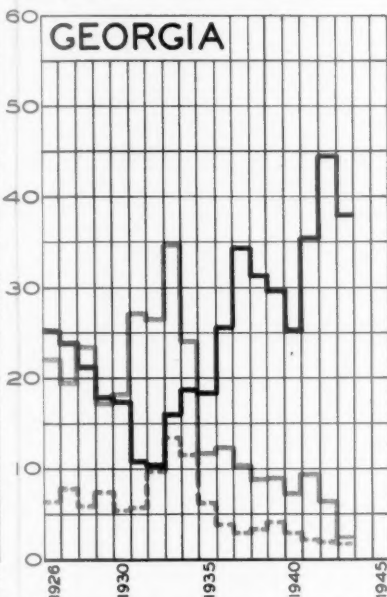
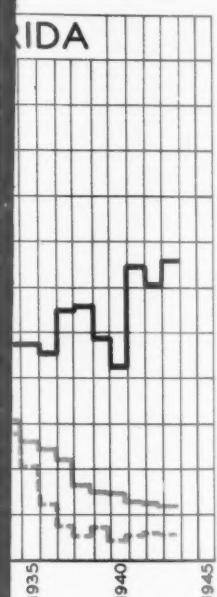
COPYRIGHT 1943

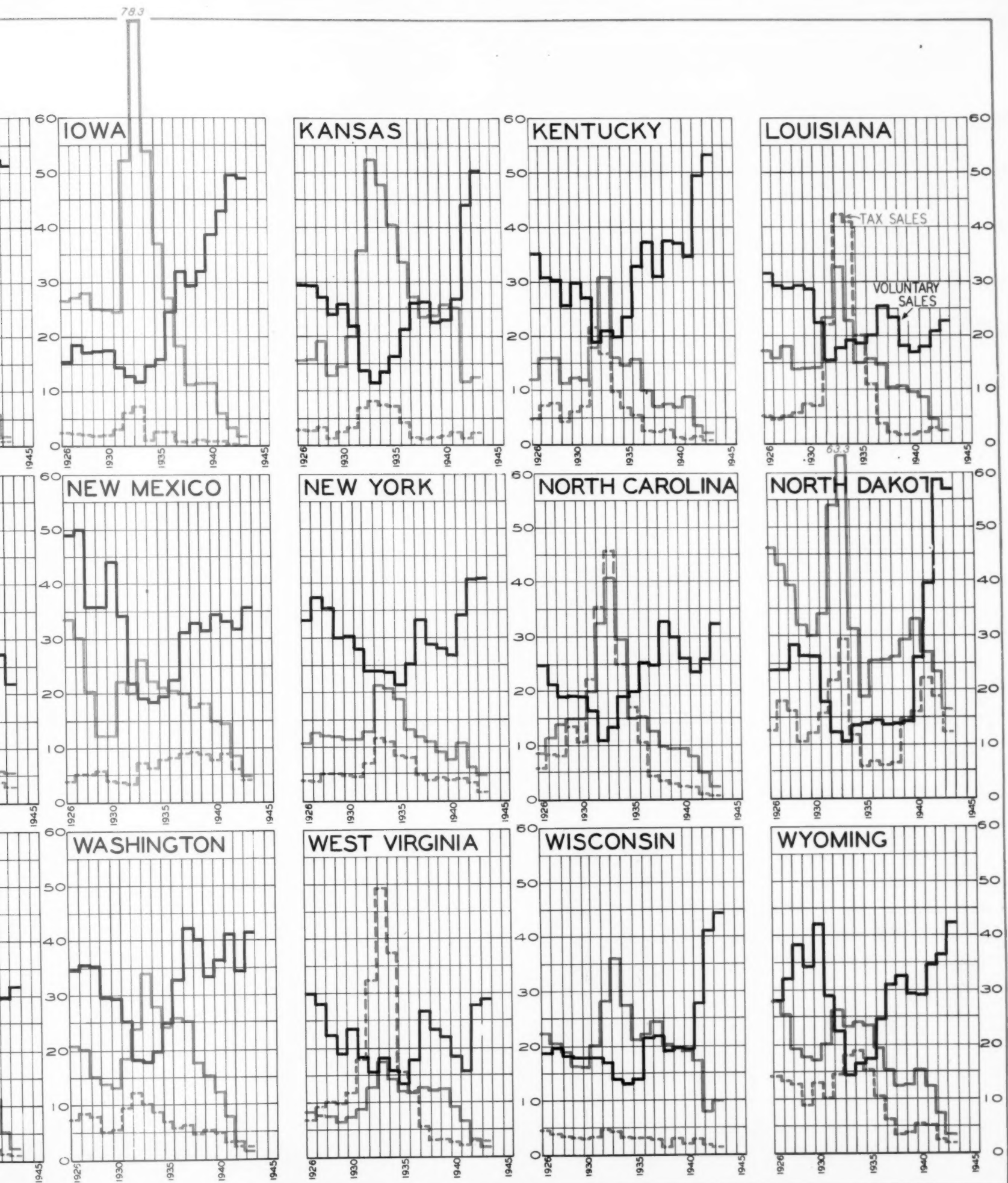


SALES OF FARMS IN 48 STATES

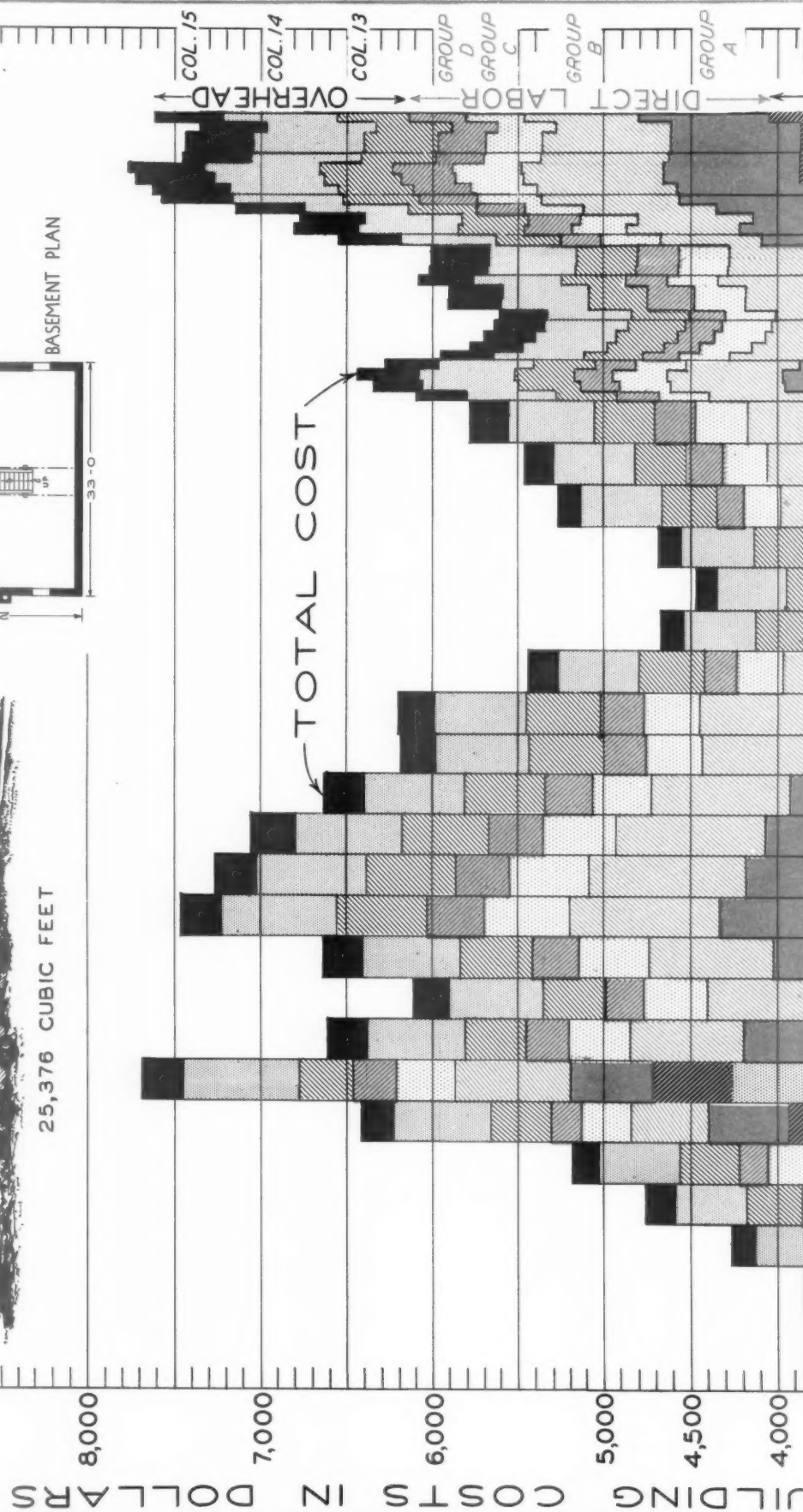
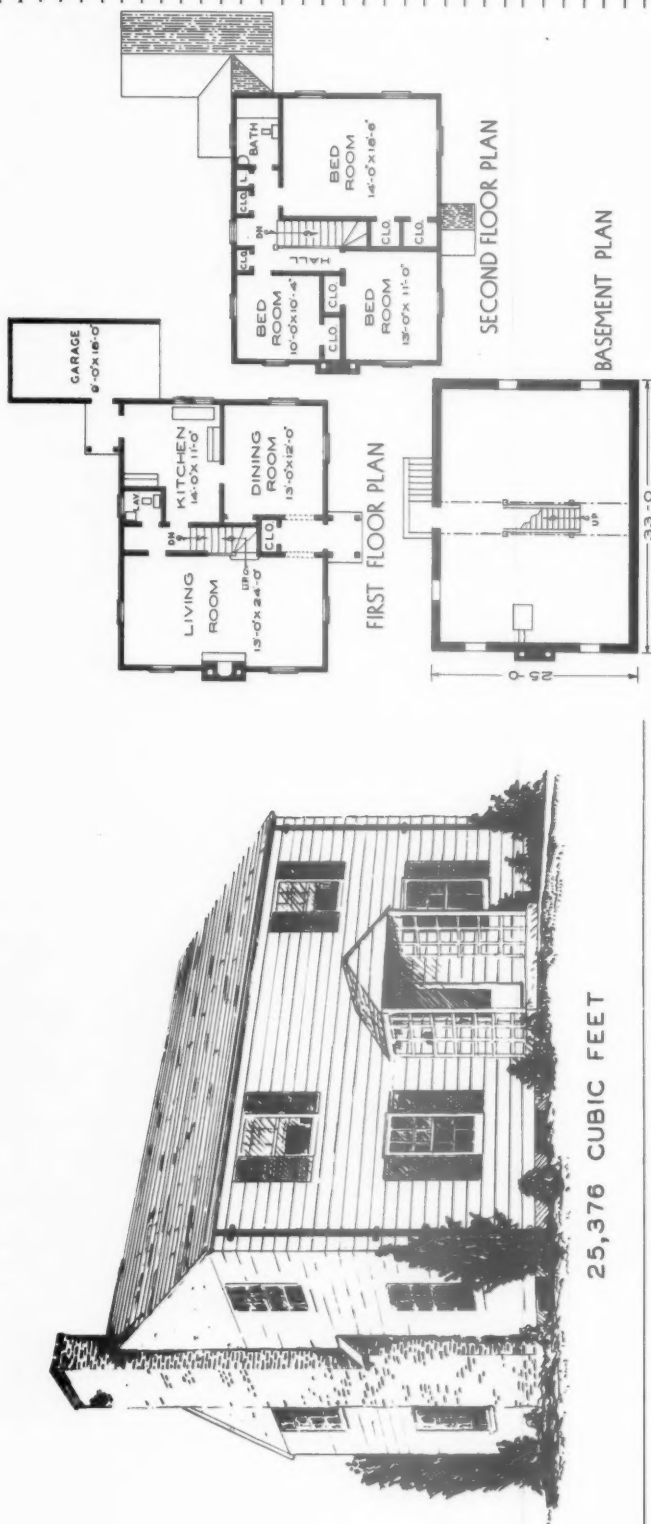
1000 OF ALL FARMS
BY WENZLICK & CO.

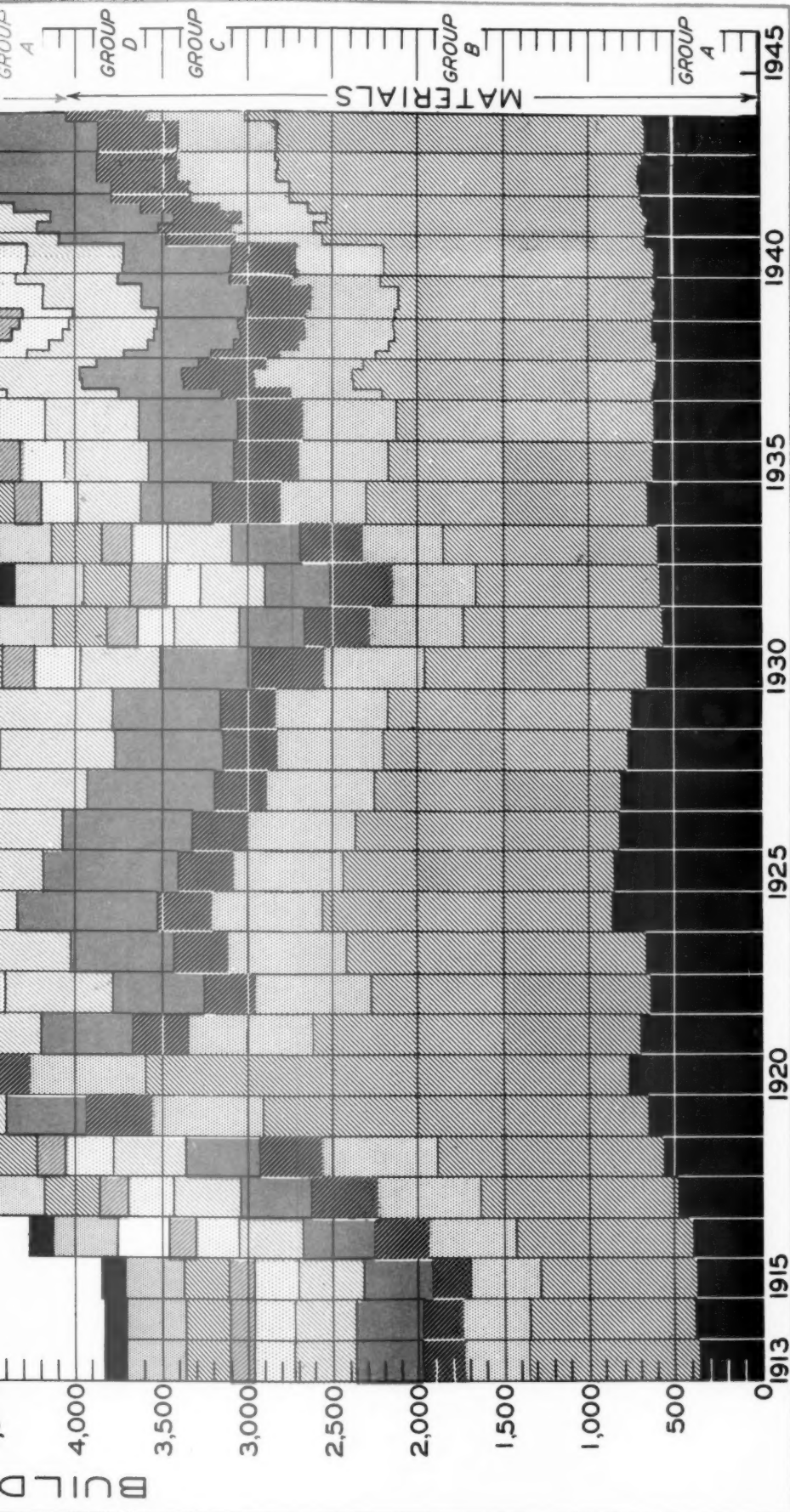
SAINT LOUIS





BUILDING COSTS OF A STANDARD SIX ROOM FRAME RESIDENCE BUILT IN ST. LOUIS





The chart above shows the variations in the costs of materials, labor and overhead for a six-room frame residence in St. Louis. Floor plans and a picture of the house are shown with the chart. Costs are grouped into four classifications of material, four of labor and three of overhead. A further breakdown of these groups is given in detail below. Columns of the table are numbered, and a brief description of the items included in each is given in the paragraphs below.

GROUP A:
(1) Masonry: Cement, sand, gravel, quicklime, hydrated lime, hard wall plaster, face and common brick, fire brick, flue lining.
(2) Tile Work: 4 1/2" wall tile, ceramic floor tile, cup and base.
(3) TOTAL OF GROUP A: Materials. Labor.

GROUP B:
(4) Unfinished Lumber: Columns, beams, floor and ceiling joists, interior and exterior studs, rafters, bracing, etc. Labor.
(5) Finished Lumber: Sub-flooring, sheathing, beveled siding, finished floors, asphalt shingle roofing, roofing felt, tar paper, shutters, etc. Labor.
(6) Millwork: Windows, doors, trim, kitchen cabinet, stairs. Labor.

GROUP C:
(7) Heating: Boiler, insulating jackets, fittings, tools, pipes, connections, valves and radiation. Labor.
(8) Plumbing: Soil pipes and connections, stack, water pipe and connections, lead oakum and bathroom fixtures; hot water heater and tank to be furnished by others. Labor.
(9) TOTAL OF GROUP C: Materials. Labor.
(10) Sheet Metal: Galv. iron (present) gutters, downspouts, flashing. Labor.
(11) Electrical Work: Main switch, BX cable, switch boxes, receptacles, transformer, etc. No fixtures included. Labor.
(12) Halls and Hardware: Common and wire nails, bolts, damper, etc. Labor.

GROUP D:
(13) Painting: White lead, linseed oil, turpentine. Labor.
(14) Misc.: Metal & wood laths, corner bead, insulation. Labor.
(15) TOTAL OF GROUP D: Materials. Labor.
(16) TOTAL OF GROUP E: Materials. Labor.
(17) Overhead and profit of subcontractors in plastering, heating, plumbing, metal work, electrical work and tile work.
(18) General contractor's profit.
(19) Miscellaneous sales tax (now 2% on materials). Old age and unemployment tax (Federal and State). Liability and employees' compensation insurance, fire and tornado insurance, completion bond.
(20) TOTAL OF GROUP E.
(21) TOTAL CONSTRUCTION COST.
(22) TOTAL CONSTRUCTION COST.

YEAR	GROUP A					GROUP B					GROUP C					GROUP D					GROUP E					TOTAL
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
1913	\$243	\$706	\$24	\$13	\$67	\$401	\$218	\$101	\$428	\$174	\$250	\$121	\$996	\$756	\$147	\$76	\$231	\$110	\$387	\$296	\$16	\$54	\$51	\$15	\$227	\$132
1914	\$262	\$384	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1915	\$260	\$384	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1916	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1917	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1918	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1919	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1920	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1921	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1922	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1923	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1924	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1925	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1926	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1927	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1928	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1929	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1930	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1931	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1932	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1933	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1934	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132
1935	\$266	\$396	\$24	\$13	\$76	\$401	\$212	\$101	\$415	\$174	\$248	\$110	\$395	\$246	\$147	\$76	\$248	\$110	\$395	\$246	\$16	\$54	\$51	\$15	\$227	\$132

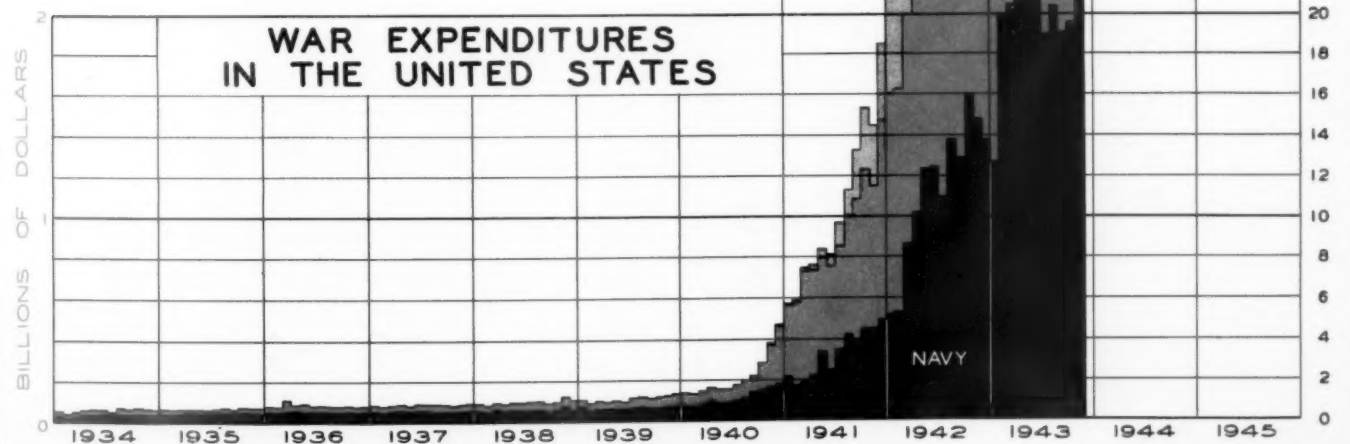
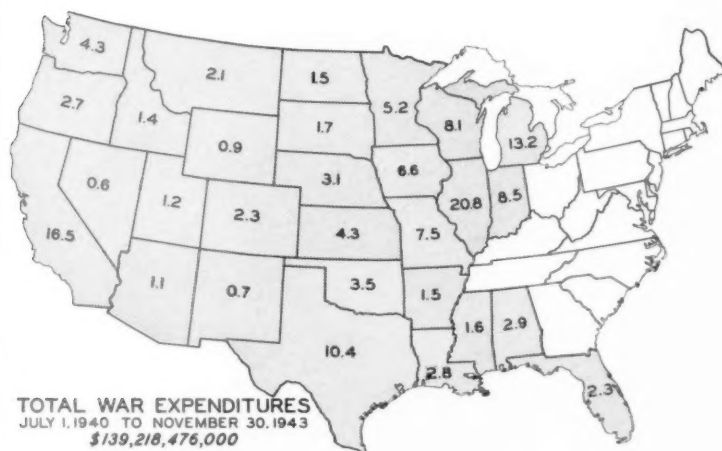
1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076	2077	2078	2079	2080	2081	2082	2083	2084	2085	2086	2087	2088	2089	2090	2091	2092	2093	2094	2095	2096	2097	2098	2099	2100	2101	2102	2103	2104	2105	2106	2107	2108	2109	2110	2111	2112	2113	2114	2115	2116	2117	2118	2119	2120	2121	2122	2123	2124	2125	2126	2127	2128	2129	2130	2131	2132	2133	2134	2135	2136	2137	2138	2139	2140	2141	2142	2143	2144	2145	2146	2147	2148	2149	2150	2151	2152	2153	2154	2155	2156	2157	2158	2159	2160	2161	2162	2163	2164	2165	2166	2167	2168	2169	2170	2171	2172	2173	2174	2175	2176	2177	2178	2179	2180	2181	2182	2183	2184	2185	2186	2187	2188	2189	2190	2191	2192	2193	2194	2195	2196	2197	2198	2199	2200	2201	2202	2203	2204	2205	2206	2207	2208	2209	2210	2211	2212	2213	2214	2215	2216	2217	2218	2219	2220	2221	2222	2223	2224	2225	2226	2227	2228	2229	2230	2231	2232	2233	2234	2235	2236	2237	2238	2239	2240	2241	2242	2243	2244	2245	2246	2247	2248	2249	2250	2251	2252	2253	2254	2255	2256	2257	2258	2259	2260	2261	2262	2263	2264	2265	2266	2267	2268	2269	2270	2271	2272	2273	2274	2275	2276	2277	2278	2279	2280	2281	2282	2283	2284	2285	2286	2287	2288	2289	2290	2291	2292	2293	2294	2295	2296	2297	2298	2299	2300	2301	2302	2303	2304	2305	2306	2307	2308	2309	2310	2311	2312	2313	2314	2315	2316	2317	2318	2319	2320	2321	2322	2323	2324	2325	2326	2327	2328	2329	2330	2331	2332	2333	2334	2335	2336	2337	2338	2339	2340	2341	2342	2343	2344	2345	2346	2347	2348	2349	2350	2351	2352	2353	2354	2355	2356	2357	2358	2359	2360	2361	2362	2363	2364	2365	2366	2367	2368	2369	2370	2371	2372	2373	2374	2375	2376	2377	2378	2379	2380	2381	2382	2383	2384	2385	2386	2387	2388	2389	2390	2391	2392	2393	2394	2395	2396	2397	2398	2399	2400	2401	2402	2403	2404	2405	2406	2407	2408	2409	2410	2411	2412	2413	2414	2415	2416	2417	2418	2419	2420	2421	2422	2423	2424	2425	2426	2427	2428	2429	2430	2431	2432	2433	2434	2435	2436	2437	2438	2439	2440	2441	2442	2443	2444	2445	2446	2447	2448	2449	2450	2451	2452	2453	2454	2455	2456	2457	2458	2459	2460	2461	2462	2463	2464	2465	2466	2467	2468	2469	2470	2471	2472	2473	2474	2475	2476	2477	2478	2479	2480	2481	2482	2483	2484	2485	2486	2487	2488	2489	2490	2491	2492	2493	2494	2495	2496	2497	2498	2499	2500	2501	2502	2503	2504	2505	2506	2507	2508	2509	2510	2511	2512	2513	2514	2515	2516	2517	2518	2519	2520	2521	2522	2523	2524	2525	2526	2527	2528	2529	2530	2531	2532	2533	2534	2535	2536	2537	2538	2539	2540	2541	2542	2543	2544	2545	2546	2547	2548	2549	2550	2551	2552	2553	2554	2555	2556	2557	2558	2559	2560	2561	2562	2563	2564	2565	2566	2567	2568	2569	2570	2571	2572	2573	2574	2575	2576	2577	2578	2579	2580	2581	2582	2583	2584	2585	2586	2587	2588	2589	2590	2591	2592	2593	2594	2595	2596	2597	2598	2599	2600	2601	2602	2603	2604	2605	2606	2607	2608	2609	2610	2611	2612	2613	2614	2615	2616	2617	2618	2619	2620	2621	2622	2623	2624	2625	2626	2627	2628	2629	2630	2631	2632	2633	2634	2635	2636	2637	2638	2639	2640	2641	2642	2643	2644	2645	2646	2647	2648	2649	2650	2651	2652	2653	2654	2655	2656	2657	2658	2659	2660	2661	2662	2663	2664	2665	2666	2667	2668	2669	2670	2671	2672	2673	2674	2675	2676	2677	2678	2679	2680	2681	2682	2683	2684	2685	2686	2687	2688	2689	2690	2691	2692	2693	2694	2695	2696	2697	2698	2699	2700	2701	2702	2703	2704	2705	2706	2707	2708	2709	2710	2711	2712	2713	2714	2715	2716	2717	2718	2719	2720	2721	2722	2723	2724	2725	2726	2727	2728	2729	2730	2731	2732	2733	2734	2735	2736	2737	2738	2739	2740	2741	2742	2743	2744	2745	2746	2747	2748	2749	2750	2751	2752	2753	2754	2755	2756	2757	2758	2759	2760	2761	2762	2763	2764	2765	2766	2767	2768	2769	2770	2771	2772	2773	2774	2775	2776	2777	2778	2779	2780	2781	2782	2783	2784	2785	2786	2787	2788	2789	2790	2791	2792	2793	2794	2795	2796	2797	2798	2799	2800	2801	2802	2803	2804	2805	2806	2807	2808	2809	2810	2811	2812	2813	2814	2815	2816	2817	2818	2819	2820	2821	2822	2823	2824	2825	2826	2827	2828	2829	2830	2831	2832	2833	2834	2835	2836	2837	2838	2839	2840	2841	2842	2843	2844	2845	2846	2847	2848	2849	2850	2851	2852	2853	2854	2855	2856	2857	2858	2859	2860	2861	2862	2863	2864	2865	2866	2867	2868	2869	2870	2871	2872	2873	2874	2875	2876	2877	2878	2879	2880	2881	2882	2883	2884	2885	2886	2887	2888	2889	2890	2891	2892	2893	2894	2895	2896	2897	2898	2899	2900	2901	2902	2903	2904	2905	2906	2907	2908	2909	2910	2911	2912	2913	2914	2915	2916	2917	2918	2919	2920	2921	2922	2923	2924	2925	2926	2927	2928	2929	2930	2931	2932	2933	2934	2935	2936	2937	2938	2939	2940	2941	2942	2943	2944	2945	2946	2947	2948	2949	2950	2951	2952	2953	2954	2955	2956	2957	2958	2959	2960	2961	2962	2963	2964	2965	2966	2967	2968	2969	2970	2971	2972	2973	2974	2975	2976	2977	2978	2979	2980	2981	2982	2983	2984	2985	2986	2987	2988	2989	2990	2991	2992	2993	2994	2995	2996	2997	2998	2999	3000	3001	3002	3003	3004	3005	3006	3007	3008	3009	3010	3011	3012	3013	3014	3015	3016	3017	3018	3019	3020	3021	3022	3023	3024	3025	3026	3027	3028	3029	3030	3031	3032	3033	3034	3035	3036	3037	3038	3039	3040	3041	3042	3043	3044	3045	3046	3047	3048	3049	3050	3051	3052	3053	3054	3055	3056	3057	3058	3059	3060	3061	3062	3063	3064	3065	3066	3067	3068	3069	3070	3071	3072	3073	3074	3075	3076	3077	3078	3079	3080	3081	3082	3083	3084	3085	3086	3087	3088	3089	3090	3091	3092	3093	3094	3095	3096	3097	3098	3099	3100	3101	3102	3103	3104	3105	3106	3107	3108	3109	3110	3111	3112	3113	3114	3115	3116	3117	3118	3119	3120	3121	3122	3123	3124	3125	3126	3127	3128	3129	3130	3131	3132	3133	3134	3135	3136	3137	3138	3139	3140	3141	3142	3143	3144	3145	3146	3147	3148	3149	3150	3151	3152	3153	3154	3155	3156	3157	3158	3159	3160	3161	3162	3163	3164	3165	3166	3167	3168	3169	3170	3171	3172	3173	3174	3175	3176	3177	3178	3179	3180	3181	3182	3183	3184	3185	3186	3187	3188	3189	3190	3191	3192	3193	3194	3195	3196	3197	3198	3199	3200	3201	3202	3203	3204	3205	3206	3207	3208	3209	3210	3211	3212	3213	3214	3215	3216	3217	3218	3219	3220	3221	3222	3223	3224	3225	3226	3227	3228	3229	3230	3231	3232	3233	3234	3235	3236	3237	3238	3239	3240	3241	3242	3243	3244	3245	3246	3247	3248	3249	3250	3251	3252	3253	3254	3255	3256	3257	3258	3259	3260	3261	3262	3263	3264	3265	3266	3267	3268	3269	3270	3271	3272	3273	3274	3275	3276	3277	3278	3279	3280	3281	3282	3283	3284	3285	3286	3287	3288	3289	3290	3291	3292	3293	3294	3295	3296	3297	3298	3299	330
------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	------	-----

NEW PEAK IN WAR EXPENDITURES

DURING November war expenditures totaled \$7,541,399,000. This was the largest monthly total to date, exceeding the June figure by a slight margin. Of this amount, \$4,172,847,000 was for the Army, \$2,133,728,000 was for the Navy, and \$1,234,824,000 for other war activities. Our total war expenditures from July 1, 1940, to November 30, 1943, totaled \$139,218,476,000. Figures of this size are incomprehensible. In order to give some idea of their magnitude we used the map of the United States below.

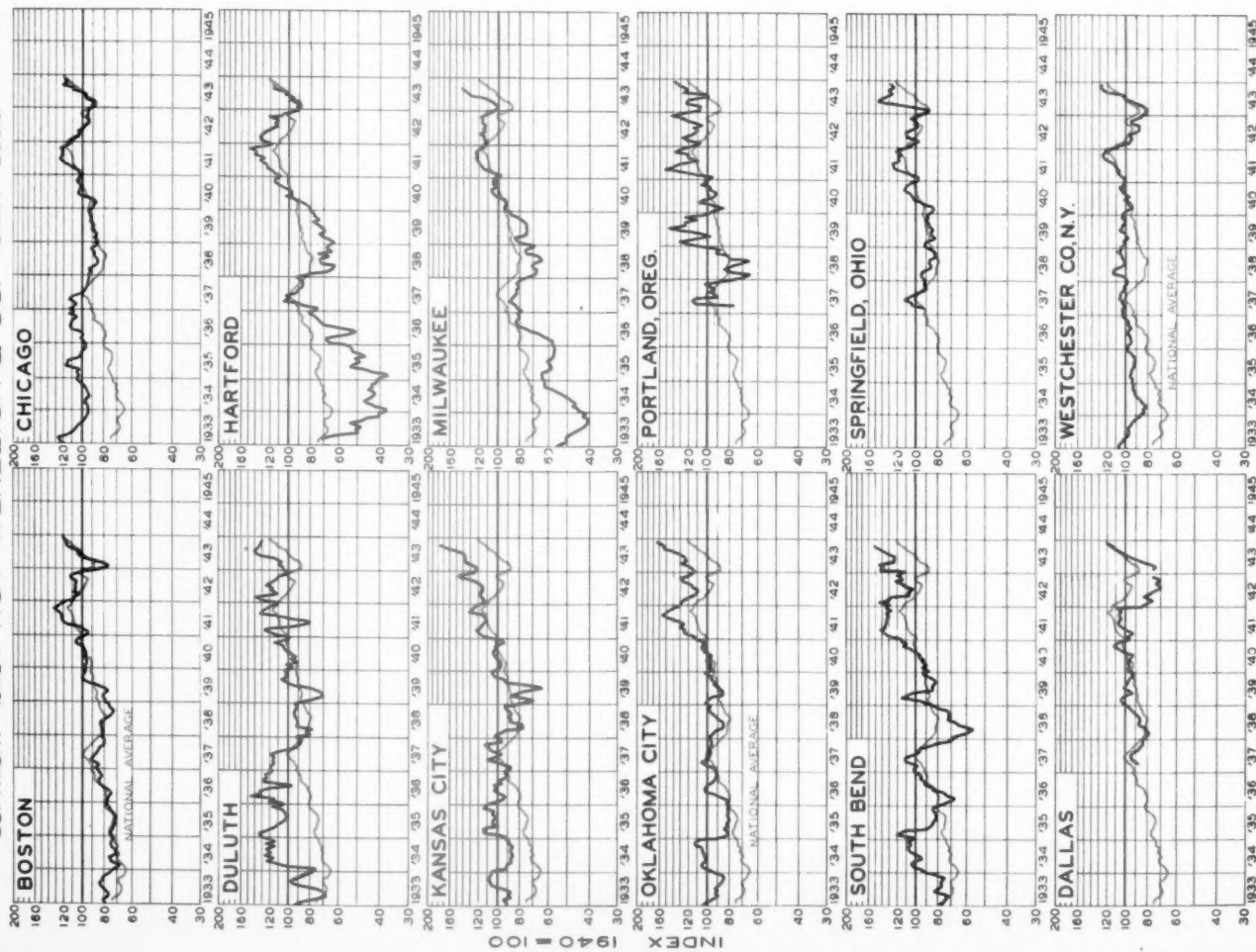
The National Industrial Conference Board estimated the total wealth of all States in the Union as of 1937. The amounts expressed in billions are shown on the map. The shaded States aggregate a total approximately equivalent to the war expenditures from July 1, 1940, through November 30, 1943. By total wealth in 1937 was meant the value of all real and personal property of all sorts.

This illustration is not used in criticism of the war effort but in order to indicate the difficulty of trying to control inflation in view of expenditures of this size.



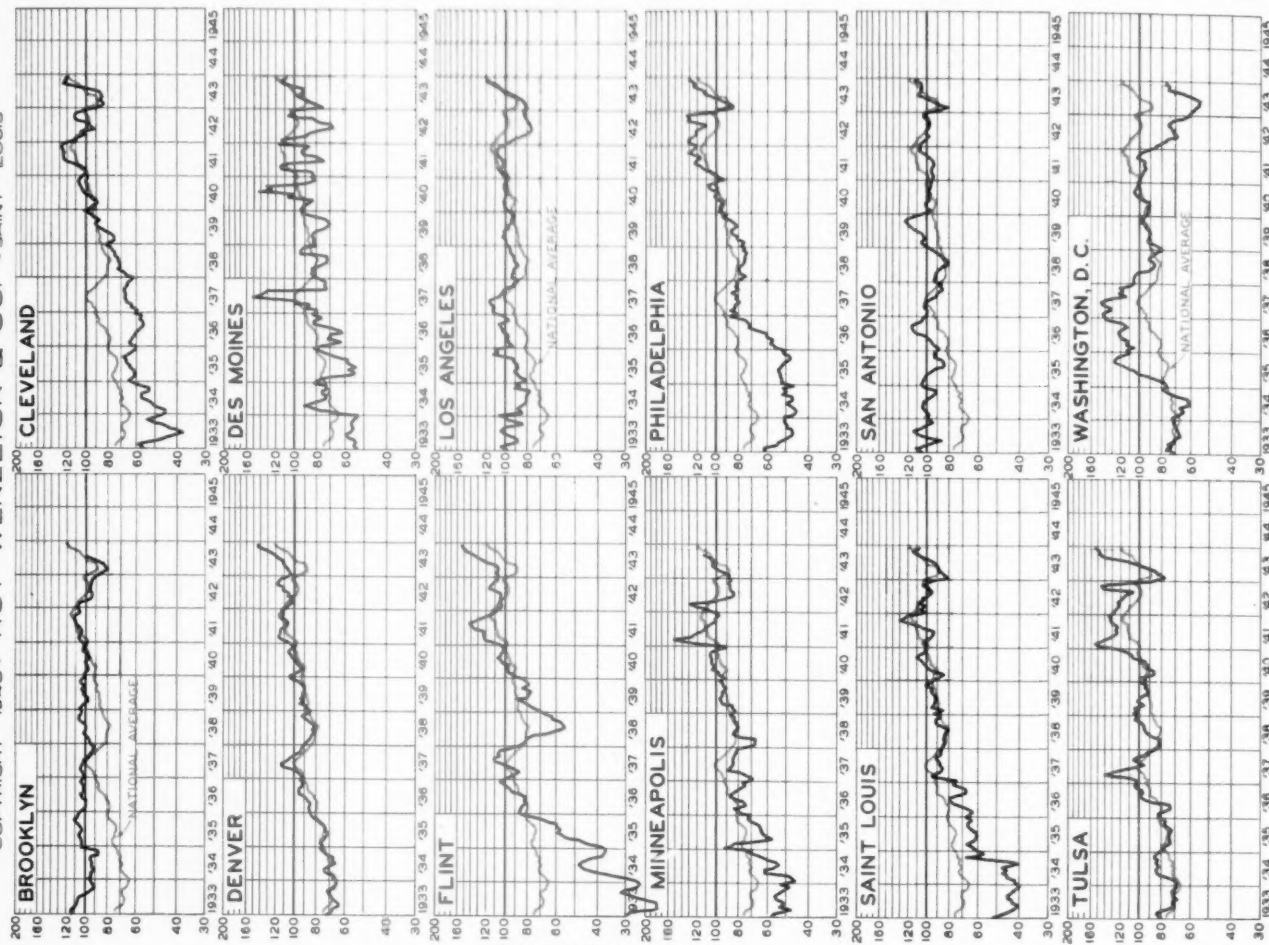
REAL ESTATE TRANSFERS IN PRINCIPAL CITIES

COPYRIGHT 1943 - ROY WENZLICK & CO. - SAINT LOUIS

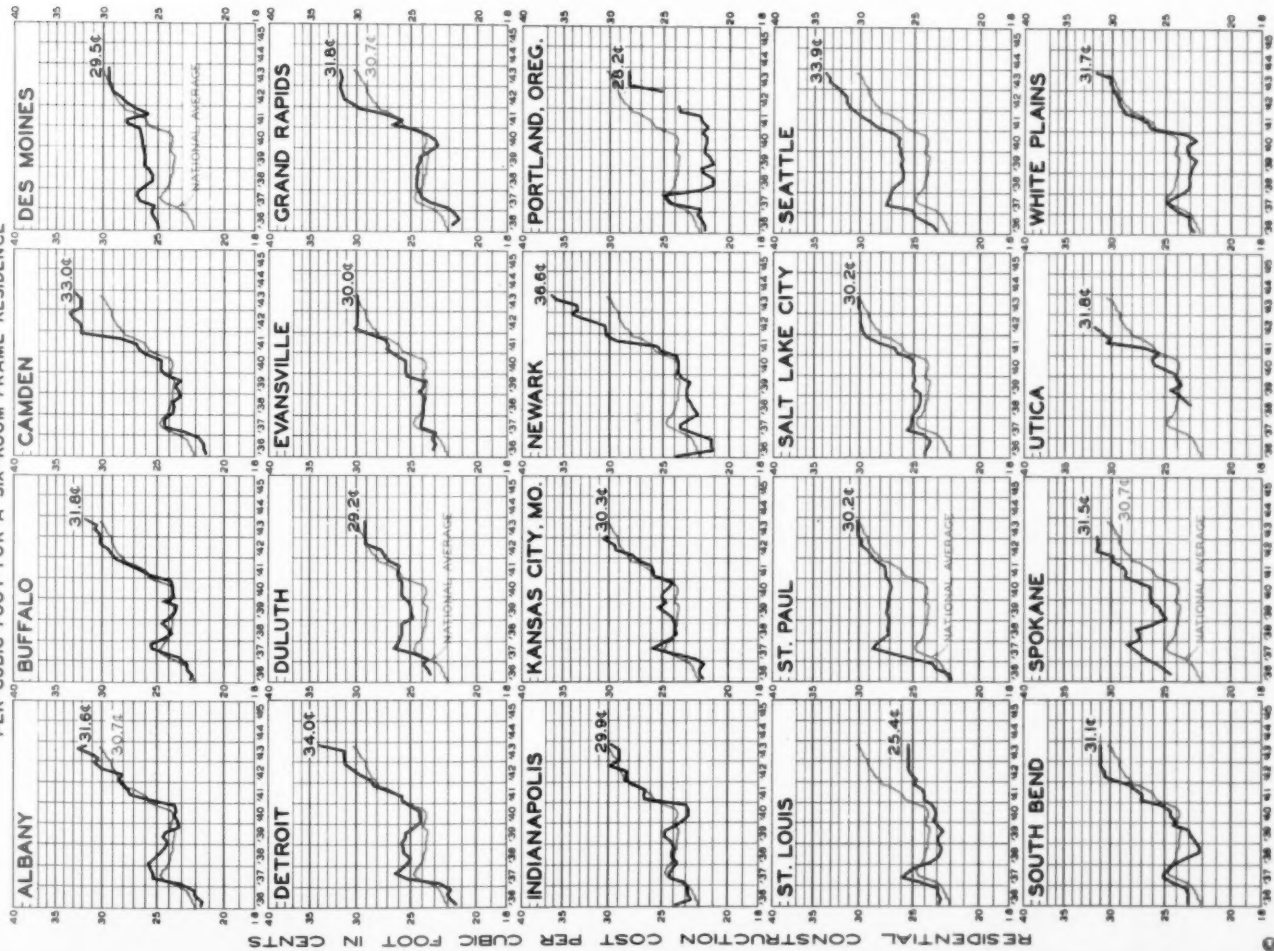


REAL ESTATE TRANSFERS IN PRINCIPAL CITIES

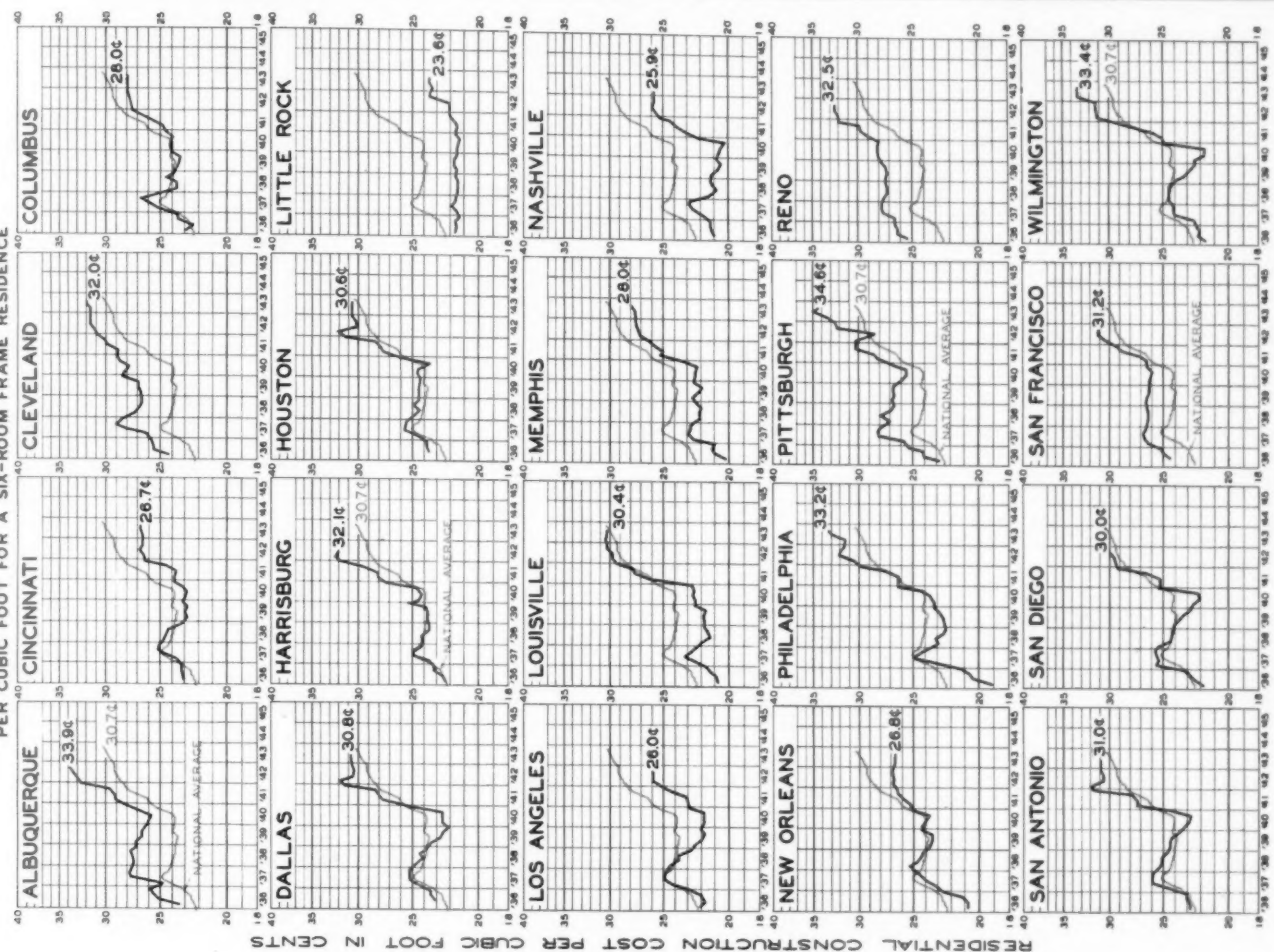
COPYRIGHT 1943 - ROY WENZLICK & CO. - SAINT LOUIS



RESIDENTIAL CONSTRUCTION COSTS PER CUBIC FOOT FOR A SIX-ROOM FRAME RESIDENCE



RESIDENTIAL CONSTRUCTION COSTS PER CUBIC FOOT FOR A SIX-ROOM FRAME RESIDENCE

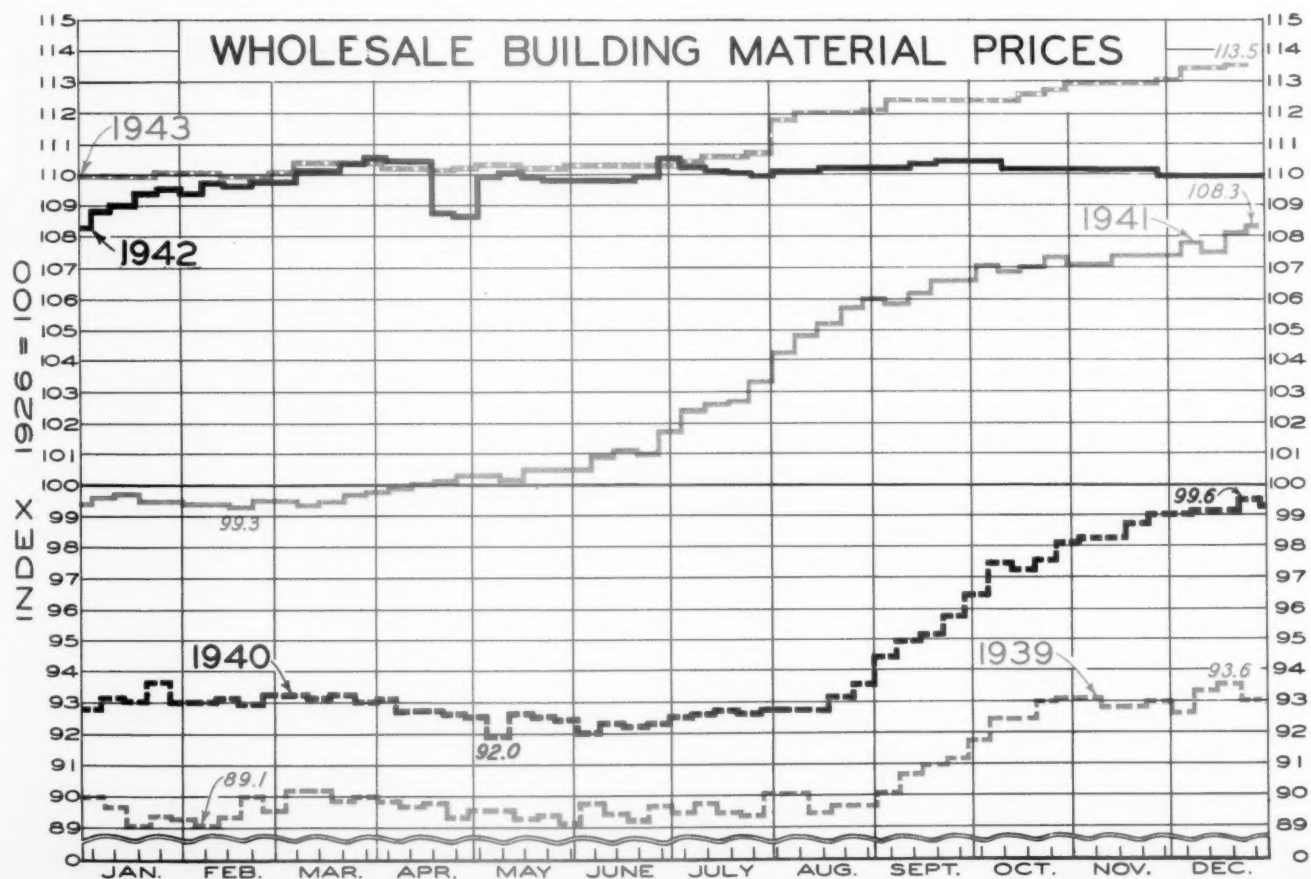


DWELLING UNITS CONSTRUCTED IN 48 STATES

THE number of new family accommodations built in all nonfarm communities of the 48 states and the District of Columbia is shown in the table below. Cumulative totals and twelve month moving totals for 1942 (blue) and 1943 (red) are given.

THOUSANDS OF UNITS

	MONTHLY			CUMULATIVE			12 MONTH MOVING TOTAL		
	1941	1942	1943	1941	1942	1943	1941	1942	1943
JANUARY	41.2	34.3	49.0	41.2	34.3	49.0	617.7	708.3	508.0
FEBRUARY	43.7	51.5	35.1	84.9	85.8	84.1	624.5	716.1	491.6
MARCH	60.2	52.5	30.6	145.1	138.3	114.7	638.7	708.4	469.7
APRIL	75.2	59.2	28.0	220.3	197.5	142.7	651.0	692.4	438.5
MAY	70.7	60.9	34.2	291.0	258.4	176.9	664.7	682.6	411.8
JUNE	77.2	46.2	22.9	368.2	304.6	199.8	697.9	651.6	388.5
JULY	74.6	27.2	23.3	442.8	331.8	223.1	715.0	604.2	384.6
AUGUST	69.8	27.5	27.0	512.6	359.3	250.1	729.1	561.9	384.1
SEPTEMBER	67.0	44.8	21.2	579.6	404.1	271.3	737.7	539.7	360.5
OCTOBER	56.2	29.9	27.9	635.8	434.0	299.2	727.7	513.4	358.5
NOVEMBER	46.6	29.8	27.5	682.4	463.8	326.7	729.4	496.6	356.2
DECEMBER	32.8	29.5		715.2	493.3		715.2	493.3	





EXECUTIVE DIGEST

OF THE CURRENT REAL ESTATE ANALYST REPORTS

DECEMBER
1943

ROY WENZLICK & CO.

Real Estate Economists, Appraisers and Counselors

Roy Wenzlick
Editor

VOLUME XII

Copyright 1943 by ROY WENZLICK & CO. - Saint Louis

REAL ESTATE ACTIVITY

The preliminary figure for real estate activity in November shows it 27.9% above the long-term computed normal. This compares with the final figure for October of 26.1% and for September of 24.4%. One year ago real estate activity was 6.8% above normal. In December 1941 when we entered the war, sales were 18.1% above normal and when the war started in Europe in 1939, sales were 10.4% below the long-term normal.

The rise in sales during the course of the war is the more significant when contrasted with the real estate sales experience during the First World War period. In August 1914 when the First World War started in Europe, our index of sales of real estate in the United States was 20.1% below normal. When we entered the war in April 1917, our index had declined further to 22.0% below normal. In October of 1918, right before the Armistice, the index had declined to 38.3% below normal.

We have constantly pointed out in our reports that this war started when the real estate cycle would normally be swinging up while the First World War started when the real estate cycle was normally swinging down. It is certainly significant that real estate activity has increased during this war in spite of rigid controls, while it decreased during the First World War, although practically no controls were exercised at that time.

REAL ESTATE MORTGAGES

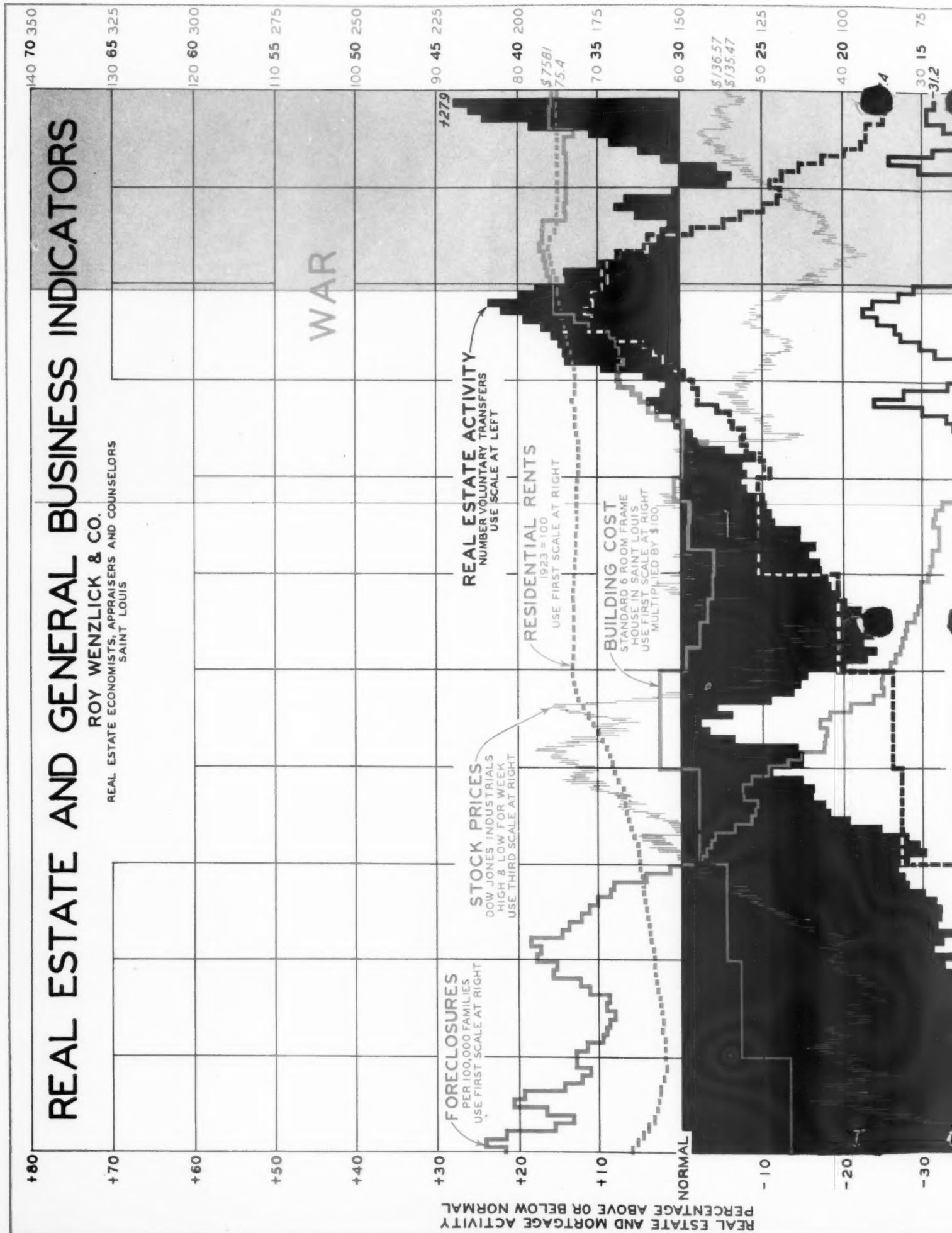
Real estate mortgage activity has shown practically no change during the past three months. In November it was 31.2% below the long-term computed normal. This is considerably higher than November of a year ago when the figure was 40.7% below normal. No great increase in mortgage activity can be expected in the next few months due to the limitations on building.

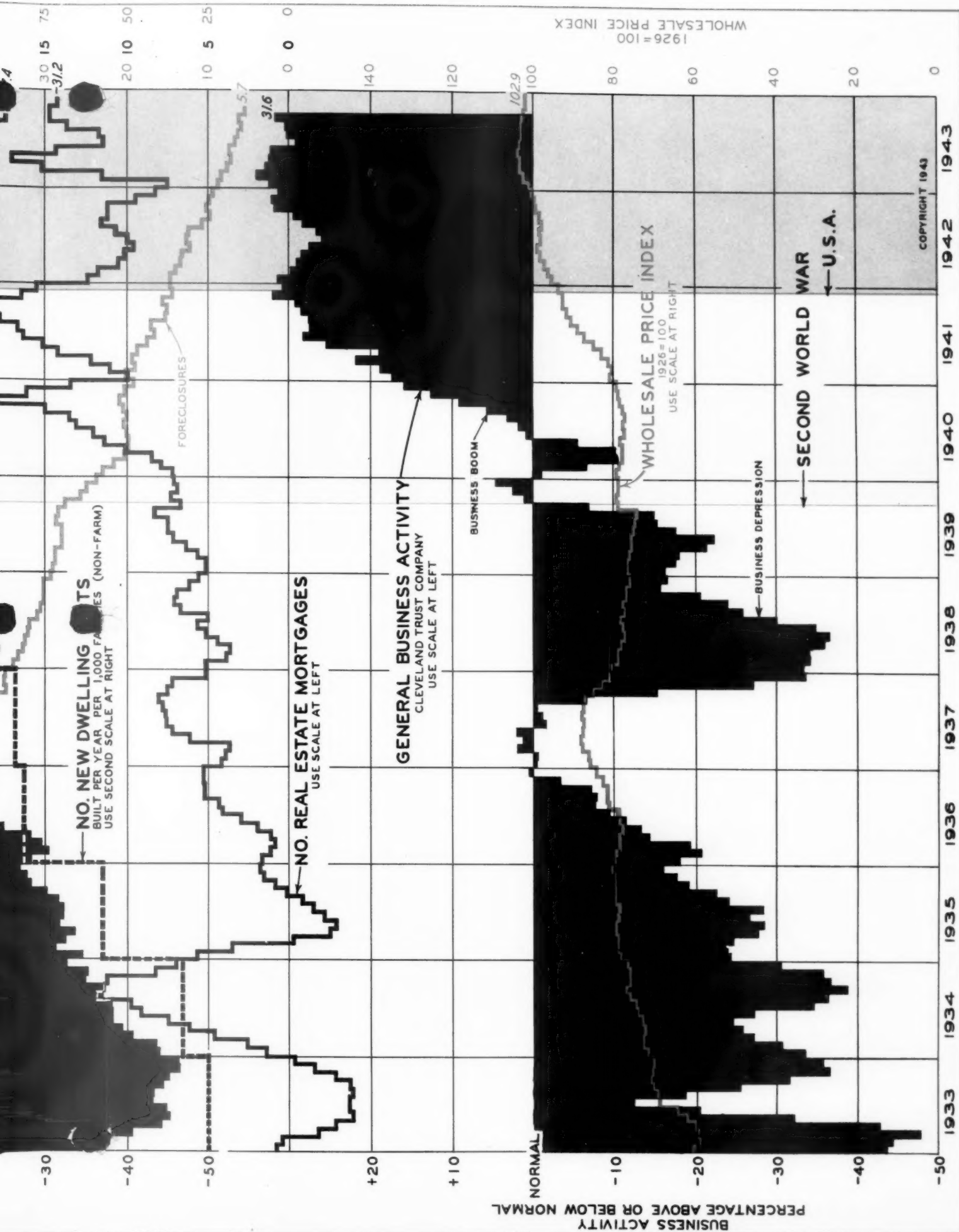
RESIDENTIAL BUILDING

During November new building proceeded at a rate equivalent to 17.4 new buildings per thousand families per year. This does not include farm units but takes in all nonfarm areas in the United States.

Practically the only building which has gone forward during the past six months has been defense housing. A year ago we were building at a rate of 24.2 new family accommodations per year per thousand families and two years ago we were building at a rate of 35.5.

There will be less building during 1944 than there has been during 1943 as most of the war migrations are now over and materials are not plentiful enough to allow a great deal of conversion back to civilian needs.





BUILDING COSTS

The cost of building the standard six-room frame residence in St. Louis in December was \$7581. This is no change over the November figure. It compares with \$7444 in December 1942.

BUSINESS ACTIVITY

It now seems quite clear that business activity passed its peak in February of 1943 and it is quite doubtful whether this peak will be surpassed in the near future. It seems that we are over the hump in the production problems connected with the war, without any possibility of large-scale reconversions.

From now on business activity will be quite spotty, proceeding at capacity levels in some communities while other communities may have for short periods considerable unemployment with resulting vacancies in residential buildings.

FORECLOSURES

The foreclosure rate during October, the last month for which these figures are available, hit a new low of 5.7 foreclosures per hundred thousand families in all nonfarm areas of the United States. Our figures on the foreclosure rate have been figured back to January 1870 and in this entire period foreclosures have never before reached so low a level.

This extremely interesting record is due to many things, among which would be the large income payments due to war activity, rising real estate values which cause individuals to make every possible effort to retain title to properties of doubtful value and to the fact that the high foreclosure rates of the thirties have gotten properties in most parts of the United States into strong hands. (Certain cities in the East still have foreclosures at a relatively high level but the foreclosure rates in these cities are more than balanced out by the almost non-existing foreclosures in most other communities.)

RESIDENTIAL RENTS

There is no change in our index of residential rents and there probably will be very little change during 1944. Rent control, at least from the standpoint of the tenant, is effective and is one of the few government controls which has actually operated in freezing a price level.

WHOLESALE PRICES

The preliminary figure for wholesale prices for December shows no change over the November figure. This figure of 102.9 compares with 101.0 of December 1942 and 93.6 of December 1941. Retail prices have risen by a larger percentage and were it possible to estimate accurately the deterioration in quality, it could be shown that the actual price increase has been greater than indicated by the index.

STOCK MARKET

The stock market as shown on the chart on the inside of this report has shown some advance since the dip, but it is quite difficult to even guess at the present time what the movement will be during the next few months. Many of the market analysts are at sharp variance in their predictions.



APPRAISAL BULLETIN

7

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

VALUE TO THE OWNER

COST AND VALUE

In Bulletin 6 the depreciating effect of inaccessibility was briefly discussed. The illustration attempted to show that the MAXIMUM VALUE of a new, modern and well constructed property did not represent its VALUE because of poor accessibility. The fact that the cost of building a new property even with good accessibility does not necessarily represent its VALUE is often encountered by the appraiser, although such a conclusion is generally questioned by the accountant, architect, contractor and owner and sometimes by mortgagees and appraisers who confuse cost and use.

All of those persons interested in building the capacity of real properties naturally feel that the money spent on construction represents the VALUE of the property, although none of them is qualified to measure the extent to which such capacity can be used. The owner's influence in deciding the type, size and quality of the property to be constructed often curtails the ability and talent of the architect. In the residential field, the speculative builder often assumes the function of the architect and does not enhance the architectural excellence of the houses he builds.

It is our belief that architectural excellence is attained when a property is constructed to provide the maximum capacity for its most efficient use at the minimum construction cost compatible with such use combining that beauty of form which gratifies esthetic nature. Utility should be the keystone of architectural excellence and today it is becoming more recognized by architects that simplicity and beauty of form result from efficient use.

The appraiser usually lacks the talent, knowledge and experience to qualify as an architect, especially on the esthetic side of design. He must know construction details, quality and costs and keep informed on the use and cost of new materials and equipment. He should have some knowledge of architectural types; however, his principal field is the economic significance of properties, not only in the construction market but in the rental market which measures the desirability of properties from the standpoint of the user and in the market of exchange which measures the desirability of the property from the standpoint of the purchaser. The appraiser's conclusion of VALUE may be below the cost of constructing a property, although the property is new, modern and well constructed with good accessibility.

When such a condition exists, it is evident that there is a portion of construction cost which is an excess and cannot be used profitably and does not represent VALUE. This distinction between cost and VALUE is one of the

important functions of the appraiser and, when found, excess construction cost must be considered as much of a depreciating influence as deterioration, obsolescence or inaccessibility. A few examples of excess construction costs and their causes are briefly discussed.

DIMINISHING RETURNS

Most of the larger cities in this country take great pride in their skylines. The skyline of Manhattan with its towers, spires and skyscrapers once seen is never forgotten. It is one of the most impressive demonstrations of American engineering and construction skill. However, there is every indication that the tower type of building of excessive height is not economically sound as an investment because of diminishing returns and, therefore, a part of the cost of construction must be considered excess construction. From an economic standpoint, the height of diminishing returns is reached when the addition of another story will not increase the net income from the property.

From a survey made by this company of more than seventy-five office buildings located in several cities throughout the country, it was indicated that the desirability of office space from the standpoint of the tenant did not increase at an increasing or uniform rate from the lower to the upper floors. In fact, it was indicated that desirability increased at a diminishing rate until a height was reached when the tenant found no appreciable increase in desirability.

From the standpoint of the owner, excessive height requires greater strength, increased construction costs and the sacrifice of rentable area for service space while the cost of operations and servicing the property is greatly increased as height is increased. None of these increases is considered by the tenant in renting space, who weighs only the desirability of space in comparison with all other competing space in the same and other buildings.

The law of diminishing returns is forgotten by those owners and architects who built monumental types of properties. It is evident that all construction beyond the point of diminishing returns is a surplusage or excess construction upon which a return cannot be expected. It is a dead investment and should be treated as depreciation the moment such properties are completed. Monuments and memorials mark dead investments and should be confined to public buildings, churches, parks and cemeteries.

The proper height of office buildings from an economic standpoint is not the same under all economic conditions. A greater height would appear justified in extremely active periods than in normal or inactive periods. The fact that the vast majority of office buildings are built in active periods produces more serious results and causes greater depreciation from excess construction.

It is self-evident that the VALUE of such properties is below the cost of construction at the time they were built. One of the pitfalls of the appraiser is to assume a lower capitalization rate in order to compensate for excess construction which cannot produce a return. Generally, the accountant erroneously carries the full construction cost on his books as an asset representing the book value of the property. With this and other types of properties where excess construction exists, the temptation is always present to assume cost instead of use as the determinant of VALUE.

In our opinion, the day of the tower skyscraper-type of office building is over, when investment possibilities are the sole consideration. When ostentation, show or the display of wealth and success is the underlying reason, owners may continue to build these structural giants with relatively weak sister investment possibilities.

With those properties where the law of diminishing returns causes decreased utility, all of the rentable space is usable, but the income from use of the property as a whole does not justify the cost necessary to construct it. There are many properties which contain costly items of construction which cannot be used or which do not enhance the desirability of the usable space. Excesses in size, strength, quality, ornamentation for purely architectural effect may prove to be unusable construction.

The question for the appraiser to determine is whether such excesses enhance the desirability of the property so that their inclusion would be reflected in the rentability or salability of the property.

In many instances we have found costly items of construction which either the architect includes in his design to gratify his own idea of esthetic effect or which the owner builds for display or to satisfy his own individual whim and taste. The individual nature and non-use aspect in many cases are easily discernible but the extent of their non-use is sometimes difficult to measure. Non-use construction is found in new properties of all types and is not necessarily excess construction resulting from the styles and types of a former period which are now out of date and considered obsolescence.

Recently we had occasion to analyze an office building, built twelve years ago, located in a mid-western city. The top six floors of the tower portion of the building were not designed for use but for purely architectural effect. It was very costly construction with expensive trim and decorative sculpturing. As shown on the plans and as an added feature of the skyline, this monumental effort of the owner and contractor was pleasing and attractive but could not be appreciated from the street. After an investigation, it was found that its construction added no desirability to the office space in the building but was a distinct liability to the property. It lowered the VALUE of the property below the level which would have been estimated if the excess had not been constructed, because net income was lowered to the extent of the insurance, taxes and maintenance and repair expenses necessitated by this excess construction.

In fact, all non-use construction which does not increase the rentability of the usable space becomes a liability. The loss in MAXIMUM VALUE (depreciation) will be greater than the cost of reproducing the excess construction by an amount representing the present worth of the additional expenses incurred by the excess. The inclusion of non-use construction in real properties is one of the most important factors with which the appraiser is faced because not only is the cost of construction a waste but a penalty in addition is assessed by its inclusion.

Often banks are offenders in building excess strength and quality of construction in order to impress people with the financial soundness of their institution by massiveness and grandeur of their banking premises. The pretentious and palatial banking quarters, built of rare and expensive materials

with luxurious appointments and furnishings, do not enhance the security of deposits but are showmanship, which may mean quite the contrary. The appraiser sometimes finds in such buildings excessive construction quality, the cost of which would be so discounted by the renter or purchaser that much of it was lost (depreciated) the day it was constructed. Being a specialty property with a slim market for renting or for sale, banking quarters have low VALUE and MARKET VALUE in comparison with the cost to produce them, although excess construction is often a material factor of depreciation. Their cost should be written off very rapidly.

It is not intended to imply that banking quarters should not be substantially constructed with beauty in line and construction details, but the appraiser should be on the alert to distinguish the "Gibraltar" type of construction and excessive luxurious quality which has no general desirability, but is of value only to the particular owner.

Luxurious quality of construction in any type of property presents appraisal problems and requires a careful analysis to determine if such construction has general desirability or desirability to the owner only. When found in investment properties, the net income from the property will indicate the extent to which the grandeur and excellence of construction quality is reflected in the return from use. The pretentious hotel in New York City, which cost ten thousand dollars per room to build with services in keeping with the grandeur of construction, found the returns entirely inadequate for the expenditures made. In our opinion, such money was unwisely expended and the VALUE of the property was below the cost of construction and depreciation accrued the moment construction started.

We had occasion to appraise a small factory building in Chicago, whose former owner desired to make it a show place and included in its construction expensive exterior trim and ornamentation with interior walls faced with glazed tile. When it was appraised, the former owner had gone out of business and the tenants then renting space in the property did not consider the same enhanced desirability of the space that the former owner did. As a result, the income from the property indicated excess quality of construction.

The few illustrations given stress the difference between VALUE and value to the owner. Basically, the difference between these two concepts of value is that the former is created by desirability for general use and the latter by desirability for individual use. The owner who builds a property in an inaccessible location does so because the property has value to himself. However, the cost of construction is not VALUE as a large part of the cost may be lost due to inaccessibility. (See Bulletin 6.)

Whether the owner builds in ignorance or unwisely, beyond the height of diminishing returns, or plans construction for ostentation or display or to gratify individual whims, he is willing to make the expenditures because he considers the result of value to himself. In most instances the unwise owner feels the value to himself is the VALUE of the property and the appraiser is often criticised when he deducts as depreciation the cost and penalty for excess construction. Sentimental value which an owner attaches to properties from past association has no economic significance and is never considered by the appraiser. In like manner, excess construction which is of value only to a particular owner has no economic significance and should be treated as waste

by the appraiser.

With investment properties where annual net income is a positive measure of the benefits arising from ownership, the appraiser's problem is greatly simplified in finding the losses in value due to excess construction. It is only in those owner-occupied properties, especially of the residential types, where the benefits to ownership are indefinite satisfactions, not readily measurable in money, that the problem is more involved and the appraiser must rely to a greater extent upon his experience and judgment.

Single-Family Dwellings About 64% (23,730,000) of all dwelling units in the United States are of the single-family type, which ranges from the crude cabin to the mansion-type estate. About 58% of this type are owner occupied. The single-family dwelling and its adjacent land gratifies those basic human desires for greater freedom, privacy and comfort in establishing a home and raising a family. The crowding and congestion of the tenement type of property must be endured by many but cannot kill these underlying desires of the vast majority of families. In addition to the desires for occupancy in the single dwelling, the desire for home ownership is centered upon security and the pride which ownership creates.

The single dwelling permits also a greater expression of individual ideas and taste than any other type of property. The owner, especially the housewife, has contributed greatly to the arrangement of space and those features considered necessary for efficient and comfortable living. Architects have found the single-family dwelling most suited to exercise their ability and training in creating utility and beauty. We have had handed down to us many architectural types and styles which have stood the test of time and are quite popular today. Among these styles one of the most noticeable is the Colonial type which has lasted for more than 150 years and today remains one of the most popular. The Colonial design possesses every feature of architectural excellence; besides providing adequate and convenient arrangement of space for comfortable living without waste, it is very efficient and economical in its construction and possesses that beauty in line and form which gratifies the esthetic nature of a large percentage of home owners.

While the appraiser may have a decided personal preference for a particular type and style of architecture, when appraising he should have a neutral attitude and recognize architectural excellence whenever it exists, regardless of the style or period. In fact, there are many freakish or mongrel styles of architecture among small dwellings with impossible gables and outlandish decorative trim which still retain good rentability and salability. In South St. Louis many of these faddish types of bungalows have been constructed by contractors acting also as architects. A few years ago a bungalow was built in their midst from plans which won the prize for architectural excellence in national competition. This bungalow was of English style architecture, excellent in interior layout and design and beautiful in line and form. The owners of the bungalows with discordant architecture protested that the prize-winning bungalow was very objectionable and lowered the values of their properties because of its ugly appearance.

The appraiser is not so much concerned with architectural styles as he is with markets and the determination of deficiencies in design and excess construction which affect VALUE and MARKET VALUE. In order to stress these im-

portant factors of depreciation discussed in this bulletin, we have attempted to eliminate other influences of depreciation by assuming new and modern properties with good locations.

We believe that the basic requirements of layout essential to proper living conditions in single dwelling properties are: (1) rooms of suitable size with sufficient wall space, abundant light and necessary ventilation; (2) sufficient closets, cupboards and other storage space; (3) severance of living space from sleeping space; (4) ample space for laundering and a small work room; (5) efficient heating system and hot water heater; (6) at least one bath and preferably one bathroom for each two bedrooms.

These are basic and minimum requirements and apply to all single dwelling types including the small bungalow in the lower price class. Of course, many other features considered essential to convenient and comfortable living should be included in dwellings when the owner can afford them.

However, it is surprising how often the appraiser finds properties in the medium or higher price class which are deficient in some of the minimum requirements. We have examined many of the small ranch-type bungalows built without basement and without access to attic space but with a small utility room. One of the greatest complaints by owners of these properties is the lack of sufficient space for storage and laundering. In several cases the car was parked on the street and the garage was used for these purposes. In our opinion such a design is deficient and the property suffers loss in value from this cause. This and any other deficiencies below the minimum requirements for single dwellings, which in the opinion of the appraiser lower the desirability of the property, are depreciating influences.

Poor construction quality, either in under-strength material or poor workmanship, is a structural fault. In many cases the weakness is quite difficult to find and difficult to correct. Sometimes structural weakness from poor construction or from sub-soil faults presents a most difficult appraisal problem. The loss in value may be much greater than the cost to repair the weakness. It is fortunate that in most incorporated places minimum standards of construction are required by building codes, although in some cities inspection is lax. One of the outstanding accomplishments of FHA is the establishment of minimum construction standards and inspections at critical stages of construction progress.

In its Anglo-Saxon meaning, home has come to indicate a place of peace and rest and the scene of happy and cherished family life. It is a sacred quality created by the family which is impossible to estimate or appraise. We had occasion to hear a member of the Institute foolishly speak of these priceless qualities of home life as the amenities of a house which should be taken into consideration by the appraiser. Whether the home life of the family residing in the house approaches heaven or hell or if the house were unoccupied the appraiser would arrive at the same economic VALUE in his appraisal. The kind of home life does not appreciate or depreciate the values of residential properties.

It is our belief that the single-family dwelling lends itself better than any other type to the gratification of those human desires for creating a home. This type also permits man to gratify his individual conception of the beautiful and his longing for comfortable or luxurious living and allows him

to tickle his vanity by the display of his success in life and his own self-importance.

The appraiser is not primarily interested in the reasons for the construction, but must consider the result and whether the cost of construction represented VALUE or value to the owner. As with investment properties, many luxury-type residential properties contain those features of excess construction which have no value.

It is claimed that Nero's golden house had a portico a thousand feet long and contained three thousand rooms. This palace built at fabulous cost was torn down within four years after his suicide. No doubt this house had value to Nero alone and was not suited for any other use. It had no economic significance or VALUE the day it was constructed. In this country there are several palatial residences built by men of great wealth, not to the magnitude of Nero's golden house but upon such a scale of grandeur and luxury that many of the same adverse features are involved. We have in mind a large residential estate containing more than 120 rooms built by an industrialist of immense wealth, who included every feature of excellence of construction and luxury at a cost running into many millions of dollars. Without having even seen this property, it is evident that for residential use the property has value only to the particular owner who built it and that in all probability its entire cost of construction can be considered surplusage or excess construction.

It is realized that residential properties naturally will have wide variation in size and quality; however, we realize also that there is a point beyond which increased size and construction quality will cause such diminished desirability and will so increase the cost of ownership that the property rapidly loses its value and often becomes a liability. This is so well illustrated by the residential estate which cost several million dollars to build by a prominent capitalist in New York State who first tried to sell it and then endeavored to give it away without success and found demolition as his only recourse to relieve himself of the liability occasioned by ownership.

We have used the Nero or "white elephant" type of residence in order to illustrate extreme cases where the total cost of construction is a surplusage without economic significance. It stresses the distinction between VALUE and value to the owner. When the owner ceases to have need for this type of property, all value to him vanishes and he is left with a liability which can be removed either by demolition or, if possible, by converting it to some other use.

We do not agree entirely with the architect who stated that for any house to cost more than \$25,000 you had to start carving it. We have been unable to fix any limit beyond which a white elephant is created. It would vary for different localities and different economic conditions. Clearly, a home built beyond the size, strength and quality necessary for a home which provides every feature of comfortable and gracious living must be constructed to gratify individual whims or the desires to display wealth or exalted self-importance.

The degree of these excesses indicates the proportion of the construction cost which is money spent to gratify the owner's individual desires and which is of value to him alone. In a future bulletin an appraisal of a small residence will be given which, in our opinion, illustrates inadequate living requirements and excess construction quality.

No one can question the owner's right to build his house on any scale of excellence and luxury which gratifies his every desire, providing he complies with legal restrictions. The appraiser's function is to determine the extent of use and to establish what portion of the cost represents excess construction which is of value only to the owner. It is evident that the money expended by the owner to create value to himself alone, should be his own and not other people's money; construction cost, which included excess or non-use construction of value only to the owner, is not a sound basis for making loans and the wise mortgagee uses VALUE as the underlying security for his loan on new or old properties. While the character of the mortgagee has its place in any lending policy, it should be secondary to the policy of requiring a proper amortization of any loan.

This necessarily brief discussion on the loss in value occasioned by the deficiencies in design and excesses in non-use construction is of great importance to all interested in real estate. That confusion exists among many in the distinction between cost and use is quite evident. Perhaps one of the principal reasons is the failure to realize the broad meaning of depreciation (see Bulletin 2) and to confine its meaning to deterioration and obsolescence. We have appraised several properties where we have felt we were performing an autopsy and writing an obituary report on the causes of the cessation of economic life. More than any other cause was the failure at their inception to recognize the distinction between cost and use.

A. B. Kissack
A.B. Kissack, M.A.I.



APPRAISAL BULLETIN

8

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

EXCESS AND DEFICIENCY IN CONSTRUCTION AND DESIGN

EXCESS CONSTRUCTION

In Bulletin 7, value to the owner was discussed in a general way to illustrate the depreciating effect of excess or non-use construction when found incompatible with the use for which the property was constructed. Excess construction which is of value only to the owner does not increase the desirability and rentability of the property but increases the cost of ownership and definitely lowers its VALUE.

It is of importance to note that when the New York capitalist attempted to give his large estate away without success, the partial cost of ownership to any donee, exclusive of any return on the investment, exceeded from the donee's standpoint the satisfaction which the use of the property would render. The cost of ownership to the original owner included this return on the investment, which probably amounted to \$300,000 annually.

In 1939 we had occasion to appraise a residential property for a financial institution which was then contemplating making a loan on the property. At the time of appraisal, the house was nearing completion with only a few minor details to be finished, and the owner expected to move in within a week. The owner was a successful business man with a good credit rating (which has no bearing on the appraisal) who had strong convictions as to just what he wanted. He informed his architect of his own ideas and his desire for the latest in materials, construction details and equipment, which were followed in the design and construction of this house.

In the appraisal of this property, the ownership, location and some other features have been concealed, but as a whole the appraisal covers all of the factors which were considered in reaching our conclusion of values.

LOCATION AND ENVIRONMENT

The property is located in one of the small municipalities adjoining the City of St. Louis about 11 miles west of the central business district of St. Louis. The property is located on a boulevard which gives it good accessibility by automobile besides being one block from a bus line and two blocks from a street car line which provide convenient mass transportation. The property is conveniently located to social activities; churches, schools, neighborhood stores and a buying center are within reasonable walking distance.

The locality in which the property is built is about 70% developed with two-story brick and frame residences varying from new to forty years of age, about 70% of which are owner occupied with values ranging from \$7,500 to \$12,000. It is estimated that rents of rented properties range from \$60 to \$100 per month. The families residing in this section are white American

types with incomes warranting above average standard of living. There are no adverse racial groups in this district and no trends or encroachments apparent which would adversely affect the stability of this district; in fact, in our opinion, this district should show some improvement in the next ten years. The property and the surrounding neighborhood is zoned for residential use, which gives an added protection. From every standpoint the location and its future stability can be considered above average.

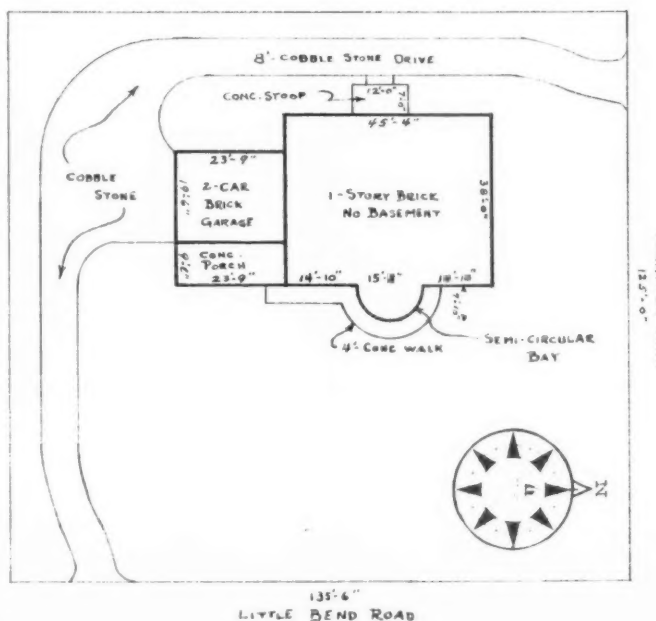
PROPERTY

The lot, with a frontage of 135'-6" on Little Bend Road, a concrete paved boulevard, and 125'-0" on Frampton Lane, a macadam paved street, lies about one foot above street grade with level topography. It is nicely wooded and provides an attractive setting for residential use. All municipal improvements are available to the property. From comparable sites in this locality a value of \$4,065 is estimated for this site, which is about \$30 per front foot of Little Bend Road frontage. (See Work Sheet I.)

As shown on the sketch, the layout of the house and drives has a good and harmonious relation to the site. Completed in the first part of 1939, the house is beautiful in line and form and shows exceptional architectural treatment. In interior design and layout, it follows the modern trend employed in the ranch type property where all rooms are located on one floor, including a utility room. The house is without a basement and without convenient access to the attic.

The dwelling contains a large combination living room and dining room with vaulted ceiling, kitchen, three bedrooms and a medium sized utility room on the first floor. A small maid's room and toilet are located over the two-car heated brick garage attached to the house. All rooms are well proportioned and there are ample closets and cupboards which indicate splendid architectural skill in design, arrangement of space and appointments. However, there is a lack of adequate storage space for household and personal effects which the home accumulates and which are necessary for convenient living; while the utility room provides space for the heating plant and laundry equipment, there is not sufficient room for drying clothes in inclement weather. Likewise, there is lack of space for gardening tools and a small work space necessary for minor repairs so essential in home ownership and no space whatever for a play or rumpus room or rathskeller which the housewife generally desires in a house in this price class. From a study of this design and the inadequacy of storage and other space, it would appear that the owner entirely ignored the desires of most home owners based upon many years of experience and planned his house to satisfy his own individual ideas.

In the construction of the property this owner apparently required the use of many of the latest materials, construction details and equipment, especially in heating and ventilating, re-



gardless of their cost. The exterior walls are constructed of 4" white silica brick, 1" air space, 1" insulite board for sheathing, 2" x 4" frame studs, plaster board base and three coat plaster with the entire space between studs insulated with U. S. spun glass. All floors are oak laid on manlite over a concrete base. Sheathing on roof is 1" insulite covered with Armco paintgrip copper alloy metal. The entire ceiling area is covered with 8" spun glass insulation. All window openings are stationary sash with double glazing. Interior trim is yellow poplar and all interior doors are 1-3/4" slab of birch. In the living-dining room, there is much moulded and ornamental plaster work. Bathrooms have tile floors and entire walls of bathrooms and kitchen are faced with structural glass.

The heating plant, located in the utility room, is a special design and custom built type gas fired with vapor jet with the heating coils located in attic space along with summer air cooling unit as well as motors for exhaust and suction fans. It combines the latest equipment for winter and summer air conditioning. Bathrooms and kitchen are provided with exhaust fans operated by Time-o-Stadt, mercury switches; kitchen sink with a stainless steel double drain board is provided with a garbage disposal device and electric dish washer. Most of the base on walls and partitions are provided with electric wall plugs every 18". The overhead doors of the garage can be operated by hand, electric switch or electric eye.

APPRAISAL

From this brief description of the property, it is evident that the quality of construction and the equipment used is quite unusual. It appears that the primary purpose of the owner was to provide complete and efficient heating and ventilating service regardless of economy in construction.

To build an almost hermetically sealed house by insulating construction when the average low monthly temperature is 32° in January and the average high monthly temperature is 79.3° in July, indicates too much stress on this requirement and nearly an obsession on the part of the owner. The other devices of electric outlets, exhaust fans, controls, etc., are no doubt very convenient and provide added comfort but are considered more of an individual whim of the owner.

The high construction cost for this three-bedroom house of \$16,390 shown on Work Sheet II was of value to this owner because he was willing to pay this amount although he had no desire for storage and other use space which generations of home owners have found essential for comfortable family life.

In our opinion, this house contains so many features of deficiency and of excess construction that its general desirability for use and ownership is greatly curtailed. On Work Sheet III we have estimated its MAXIMUM VALUE at \$20,455 and deducted as depreciation \$5,735 for undesirable livability and unsalable features which are considered of value only to its owner. This gives a VALUE of \$14,720 which also, because of market conditions, represents its MARKET VALUE.

To justify its MAXIMUM VALUE from income, a rent of \$178 per month would be necessary, which is considered above the amount the property would rent for in the market. On Work Sheet IV a rent of \$140 per month was used more in line with the market which justifies the VALUE determined from the cost approach.

A. B. Kissack
A.B. Kissack, M.A.I.



APPRAISAL BULLETIN

MARCH 25
1943

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

ADVERSE REAL ESTATE TRENDS AND CITY PLANNING

The modern appraiser is unable to reach logical conclusions of the values of real properties unless he has an understanding of all influences which may appreciate or depreciate values and a thorough knowledge of the causes of trends and decentralization and of blighted and slum areas. Today, when many vital problems confront all cities and some students even question whether our cities can survive, city planning is being advocated as part of the revolutionary movement which is so drastic in effect that the basic conception of value may be affected. The appraisal profession, whose function is to measure the usefulness of real estate in the markets established in a free political economy of private ownership, free competitive enterprise, individual initiative and choice and the profit motive, must be vitally concerned with any change in any phase of this economy and should discontinue being an onlooker, assuming a prominent place along with other real estate interests in the discussions of all proposed plans.

The engineer and architect build capacities and social activities determine their usefulness. In former bulletins this fact has been stressed and a few illustrations given to indicate that the cost of capacity does not necessarily represent VALUE. It is primarily a production problem for the engineer, architect and contractor to rebuild our cities, but the appraiser's activities lie closer to the social activities of man and measure the relation between capacity and use. If we look back to the development of our cities in the early days, there is a distinct feeling that there was a lack of plan and that development occurred in a more or less haphazard fashion as the profit motive dictated. However good our hindsight may be today, the conditions existing in those days and the future probabilities then existing should prevent us from being over-critical and blaming lack of planning and land speculators in the early days for most of our troubles today. It is in the range of probabilities that forty years from now, our plans of today may be outmoded by the use of the airplane, which by then may become the popular means of mass and individual transportation; decentralization would be extended to much greater distances and our highways, boulevards, grade separations, traffic systems and all other improvements for the automobile would decline in usefulness and value. This is not a prediction but today it is not so remote a probability, as the automobile was to the early city developers.

During the early development of the machine and the industrialization of America, population naturally migrated to our cities in constantly increasing numbers. In the early days when the horse-drawn vehicle was the sole means of transportation it was wise and advisable to build narrow streets which provided the largest percentage of land for development and to build with high land

coverage so that population could be concentrated close to places of employment, shopping and other social activities. The limitation of transportation acted as a wall in confining population in a comparatively small area almost as effective as the defense walls of ancient and medieval cities such as Florence, Jerusalem, Athens, Rome, etc. Concentration was then the pattern universally adopted by early American cities and was considered smart planning. It is extremely doubtful if our present city planners would have done differently if they had lived in those days.

With each advance in transportation facilities, more land became available for development, but often population increased faster than transportation facilities improved and concentration continued over large areas of our cities. The land speculator who bought land close to growing cities was against concentration and overcrowding and advocated extensions and improvements in transportation to favor his cheaper land. This same condition exists today. Many of the large fortunes made in real estate were by speculators holding cheap land on account of inadequate transportation until the time when increased facilities crumbled the confining "wall."

CHANGING PATTERNS

It was not until about the turn of the century when great strides were made in the efficiency of the electric motor and gas engine that most of the barriers of inaccessibility were removed, making more and more cheap and desirable land available for development. Subways, street cars, busses and the automobile with increasing speed provided mass and individual transportation beyond the imagination of the early developers. The automobile scattered population which the "horse and buggy" concentrated.

Boulevards, street widenings, speedways and grade separations were built at great cost to ease traffic congestion and to save values in the central business districts. To superimpose on an outmoded city layout the tremendous amount of modern traffic raised problems, many of which remain unsolved. In those cities with surface travel only, congestion and parking problems in the downtown districts cause great inconvenience to the shopper, which tends to decentralize business away from the central district. When streets were widened and boulevards built, it was thought and advocated by the city planners that this engineering task would maintain and enhance real estate values along the arterial traffic ways, and benefit taxes were assessed against adjoining properties because of this belief. They overlooked the fact that use was not increased but diminished by traffic which passed but did not shop.

At the same time that the improvements in transportation were taking place, vast strides were made in construction technique, and advancement in the arts and sciences developed new or more efficient mechanical and electrical equipment of every kind; plumbing, heating, electrical and elevator equipment became more efficient, providing increased conveniences and comforts for living and working which entirely outmoded the old and inefficient found in older properties. During the past twenty-five years especially, revolutionary changes have been made in our production processes. Stimulated by mass demand and high wages, modern tools and efficiency in operation with the production and assembly lines have reduced man-hours and prices. These important changes in the production processes necessitate modern industrial plants in which to operate. Plants built on one floor with large space for receiving, storing and shipping and with ample space for parking workers' cars entirely outmode the old multi-story plants often with 100% land coverage which were built when

congestion was considered essential. Hundreds of these old-style plants are found in the old sections of all metropolitan cities. Albert Kahn, the late industrial architect, predicted that nearly three-fourths of the industrial plants in America will be obsolete in the post-war period and unsuited for profitable operations in competition with modern plants. The modern plant requires large tracts of land with convenient locations away from congestion. Switch tracks and sidings have been experiencing diminishing importance for many industrial lines since the advent of the truck. With more room and cheaper land in the outlying sections, the modern plant is being drawn away from the inner city to more convenient and more profitable locations in its environs.

These are only a few instances of the effect of the out-of-dateness and inefficiencies of obsolescence which, when combined with the adverse effects of old age with all of the accompanying defects of time and use, make properties less desirable with declining values. It is, of course, unfortunate that real estate, like the individual, declines in usefulness with old age until a time is reached when expenses exceed the capacity to earn and the end of economic life is reached. The individual at that time becomes dependent upon his savings or on others, but the owner of real estate cuts expenses below the point of proper maintenance and to a poverty level in order to keep a spark of economic life aglow. This brief comment on the physical side of the capacities of real estate indicates the extreme range and extent of decline in the usefulness of all real properties. It is not a static condition but a constant process of decline caused by the march of time and the inventive genius of man in the development of the new and the more efficient.

LIMITATION OF LIVING STANDARDS

From the standpoint of the appraiser, who measures the cost of capacity as only a step in finding VALUE determined from its use, the important consideration is the economic status of the users and their ability to pay rent, especially in the residential field. We have selected St. Louis as an average city which gives a typical illustration of the economic status of tenants, which, in turn, determines the economic status of its residential properties. The City of St. Louis contains a larger proportion of its area as the inner city than most cities because its boundaries were fixed in 1876 and the most of its outlying sections are in St. Louis County - a separate political entity over which the city has no control. Many small cities in the county are contiguous with the central city and the growth of these outlying sections has been quite rapid during the past thirty years.

The chart on page 52 is prepared from 1940 United States Census data and gives the percentage of tenants and the amount of rent paid. The full line represents the actual rent paid and the dashed line a rent calculated to include heat, water, gas and electricity. The dotted line represents the combined actual rents and estimated rental values of owner-occupied homes. These Census data are for the City of St. Louis without the outlying sections.

Rents are a splendid index of family income and represent a reasonably accurate index of the status of family living standards in all its phases. This graph does give the economic status of all rented dwelling properties in the City in April 1940. The ability to pay rent is the causal influence of real estate values. The status of real estate cannot change the economic status of families nor their ability to pay rent. We find much confusion in regard to this basic concept; the mistaken idea expressed by city planners who

CITY OF SAINT LOUIS

COPYRIGHT 1943 ~ REAL ESTATE ANALYSTS, INC. ~ SAINT LOUIS

POPULATION

WHITE	706,794	86.6 %
NEGRO	108,765	13.3 %
OTHER RACES	489	.1 %
TOTAL	816,048	100.0 %
FOREIGN BORN	59,406	7.3 %
PERSONS 21 YEARS OR OVER	585,074	71.8 %
MEDIAN YEARS SCHOOLING	8.2 YEARS	
OWNER OCCUPIED DWELLINGS	62,829	25.0 %
TENANT OCCUPIED DWELLINGS	172,043	68.4 %
UNOCCUPIED	16,738	6.6 %
TOTAL	251,610	100.0 %

HOUSING

SINGLE DETACHED DWELLINGS	24.9 %
FOUR FAMILY DWELLINGS OR LESS	75.3 %
MORE THAN FOUR FAMILY	24.7 %
MEDIAN AGE DWELLINGS	35.3 YEARS
DWELLINGS WITHOUT PRIVATE BATH	29.4 %
DWELLINGS WITH RUNNING WATER ONLY	19.8 %
DWELLINGS WITHOUT CENTRAL HEATING	37.0 %
1/6 TENANTS PAY \$11.50 OR LESS PER MO.	
1/3 TENANTS PAY \$16.00 OR LESS PER MO.	
1/2 TENANTS PAY \$20.00 OR LESS PER MO.	
2/3 TENANTS PAY \$26.50 OR LESS PER MO.	
5/6 TENANTS PAY \$35.50 OR LESS PER MO.	

HORIZONTAL SCALE - 10% = 17,204 TENANTS

MONTHLY RENT

1/6 TENANTS

1/3 TENANTS

1/2 TENANTS

2/3 TENANTS

5/6 TENANTS

COMBINED RENT
TENANT AND OWNER
OCCUPIED

GROSS TENANT
RENT

ACTUAL RENT

PERCENTAGE OF TOTAL TENANTS (172,043)

100

90

80

70

60

50

40

30

20

10

0

\$150

140

130

120

110

100

90

80

70

60

50

40

30

20

10

claim that obsolete properties are conducive to poverty and all its accompanying deficiencies when, in truth, poverty is the sole cause of keeping a spark of economic life remaining in extremely obsolete dwellings. From the standpoint of the appraiser, if the tenants renting dwellings in St. Louis could be housed in new and modern dwellings at the same rents shown in the graph, the value of the new construction would not be substantially different from the value of the old and obsolete dwellings in which they now live.

It is believed that April 1940, when rents were recorded, represents a fairly normal period and rents were not adversely affected either by deflationary depressions of losses and want or stimulated by inflationary booms of profits and excesses. A study of the rent graph reveals many interesting facts. There are no clearly defined stratifications, but rents rise gradually from very low levels for five-sixths of the 172,043 families paying rent and then rise very sharply upward. One-sixth pay \$11.50 or less per month; one-third pay \$16.00 or less per month; one-half pay \$20.00 or less per month; two-thirds pay \$26.50 or less per month and five-sixths pay \$35.50 or less per month. The conclusion would be justified that a half to two-thirds of the families renting dwellings in St. Louis could not afford to pay the rent of three- and four-room apartments in new and modern projects. The Parkchester project in the Bronx, the largest privately owned unsubsidized housing development in the world, which houses more than 12,000 families of more than 40,000 persons, secures rents for its three- and four-room apartments ranging from \$39.00 to \$63.00 per month, depending upon their positional location. This mass production project, constructed with every saving in construction cost, was built on land acquired at 71¢ per square foot or about \$31,000 per acre. With only 27% of its area covered with buildings, it was necessary to build the apartments 7 to 13 stories in height and concentrate nearly 95 families per acre (320 persons) at these rents in order to justify a low rate of return on the cost of land and improvements. A similar development in St. Louis could secure tenants for three- and four-room apartments from only the upper sixth rental group if the same low cost of construction and same land cost could be secured. It is doubtful if land in the inner City of St. Louis could be assembled for \$31,000 per acre. However, at rents averaging \$13.00 per room in Parkchester it necessitated a high population density to pay a small return on a land value of \$31,000 per acre. This density applied on only 4 of the 64 square miles in the City of St. Louis would house its entire population. It is quite interesting to note that this density applied to St. Louis County, containing 318,000 acres, would house over a hundred million persons, or over 75% of the population of the United States.

BLIGHT AND SLUMS

It is evident that deterioration and obsolescence are not of themselves a cause of blighted or slum areas unless these adverse influences are accompanied by lower living standards and lower rents. It is recognized that successively lowering living standards with lowering rents are the underlying cause of blight. It is incompatible living standards which depreciate the value of a large residence in a neighborhood of bungalows whether the properties are obsolete or new. Deed restrictions protect against the encroachment of adverse living standards of a social, cultural, racial and economic nature. On the other hand, some neighborhoods are not blighted when the living standards are maintained at a high level, although the properties may suffer from obsolescence. Modernization will enhance values in such cases, although when the neighborhood living standards are lowered, the cost of modernization generally does not increase values proportionately.

In slum areas where extreme obsolescence is present, again it is extremely low living standards which hold such neighborhoods at poverty levels with every accompanying phase of living at a sub-standard status. It has long been our opinion that slum areas would not exist if it were not for the sub-standard families which reside in them. This is so well illustrated by comparing Yorkville and the Lower East Side in Manhattan, New York, where the dwellings in both are the same in construction, age and obsolescence but the living standards and cleanliness in the former are much higher than in the latter.

A cure for low earning capacity is not found by the engineer, architect and social worker through city planning, zoning laws and city rebuilding. Any real remedy requires an understanding of causal and contributing influences which cause inefficiency, ignorance and unwholesome characters. In spite of sermons and political declarations it is a fact that men are not created equal in physical or mental capacity nor are they endowed equally in personality, talent or aptitude, nor can individuals attain equality in those characteristics which lead to successful and efficient accomplishment, or the assumption of responsibility and leadership. The inability or unwillingness of many to compete with others is naturally reflected in the wide variations in payment for services. As far back as history goes, there is no mention of equality but on the contrary, the inequalities of mankind have always been recognized. Every measurement of intelligence, admittedly incomplete, indicates a wide range in the capacity to acquire knowledge and skill among all individuals. A physics professor once remarked on the large numbers dropping out of the freshman classes, "You can't pour a gallon into a one quart vessel." Just so long as the capacities to produce or serve vary greatly, there will continue to be a wide variation in earning capacity. That some of the underlying causes are inherent is the opinion of many recognized authorities. It is not the purpose to discuss whether our present political economy awards to each individual fair and just compensation for the services and work he performs. Certainly, business and industry cannot possibly afford to pay the same wage to the inefficient and incompetent that they do to the skilled and competent workman.

POST-WAR PLANNING

It is a mistake, or rather misrepresentation, to claim that excessive obsolescence is the causal influence of poverty and those excessive deficiencies which are found existing in slum areas. Granted that bad housing conditions and overcrowding are conducive to sickness and epidemics, it is childish reasoning to claim that housing conditions are the cause of infant mortality, juvenile delinquency, rape, social diseases, thievery and other crimes. Such delinquencies are basically the result of deficiencies in the individual and not in the housing. The recent report of the National Resources Planning Board recognizes the social nature of the problems involved. The solution offered is believed to be too Utopian, idealistic, impractical and socialistic to be followed by Congress in its entirety. That social security will be enlarged and extended for the dependency of old age appears certain, and also that construction will constitute a substantial part of cushion employment in the post-war transition period appears quite probable. Government guarantees and underwriting of food, housing, schooling and medical care, together with subsidized rents, tax exemptions, low interest financing for the benefit of some at the expense of others are dangerous weapons in the hands of politicians whose tenure in office depends on votes. To make so many millions wards of the Government in order to raise their standards of living at the expense

of the capable, diligent and thrifty without curing the underlying causes of low income, may well stifle incentive and bog down our entire economy. You cannot raise the standards of living of groups or of nations by the dole or by government spending.

Public housing projects are in an experimental state; they are institutions and economic liabilities and can be classed with other public institutions such as the poorhouse, asylum, penitentiary, etc. Producing no return, such properties have no VALUE or MARKET VALUE, although their cost may be justified as a social corrective. At the present average rents for USHA projects, with \$14.73 actual rent per month and \$21.10 gross rent per month, only those selectees from among those families in the upper half of the lower third rental group and in the lower half of the middle third rental group in the City of St. Louis would be favored (see rent graph). Doubtless, it is intended to extend institutional housing to all persons with a low income status to prevent favoritism and discrimination. Perhaps those nomadic knights of the road who now live in the jungles and ride the rods could be provided modern tourist camps and pullmans at government expense. Seriously, all persons below a minimum income, no matter how weak in ability, character and habits, should be provided equal opportunity to live at government expense in a democratic society. The lowest income families do not migrate from the inner city to the outlying sections and all public housing projects are for relief purposes and not for city rebuilding to prevent decentralization and increase population in the inner city.

Post-war plans for inner city rebuilding are now being formulated, and laws are being advocated for urban development corporations with the right of eminent domain to assemble large tracts of land and redevelop them with new and modern structures. These corporations are to be under advisory control and dividends are limited.

In all metropolitan cities, rebuilding the inner city in order to halt decentralization and increase population in the inlying sections faces economic forces almost impossible to overcome. The unfavorable factors against profitable urban redevelopment of the inner city are (1) the high cost of land acquisition which must include the remaining values in the existing improvements in comparison with land values in the outlying sections; (2) modern industrial plants seeking locations in the outlying sections; (3) easier building codes and zoning restrictions in the outlying sections; (4) land values acquired in the inner city are far too high to build single-family dwellings for owner occupancy in comparison with outlying sections with larger lots and better environment; (5) all residential redevelopment in the inner city must be of the multi-dwelling type with low land coverage but a high concentration of families per acre; (6) there are insufficient families in the inner city with sufficient income to pay the rent necessary to justify a limited return on the high cost of land acquisition and the cost of new and modern structures (see rent graph), which will permit only a small part of the inner city to be rebuilt; (7) it will be necessary to finance such projects with low government financing and to secure tax exemption in order to better compete with the outlying sections.

It is not believed that it will be legally possible to penalize the outlying sections in order to lower their desirability. However, it is our opinion that decentralization cannot be halted but will continue in the post-war period, perhaps at a more rapid pace than it has in the past. Unfair advan-

tage given new housing developments in the inner city through government financing and tax exemptions will make such housing developments semi-public or institutional in nature. Such socialization of residential properties will tend to deepen blight and lower values in other parts of the inner city which must compete without subsidy. Socialization and free enterprise cannot exist together without economic chaos.

The foregoing brief discussion does not mean that we favor obsolete housing unsuited for habitation. The police power of state and city should have legal authority to require minimum habitation standards which should be rigidly enforced. Non-compliance should cause prompt demolition by the city as effective as the destruction of unwholesome food. Likewise, we favor legal minimum standards of maintenance and repair. It should be illegal for any owner to allow his property to so deteriorate that it would lower the values of surrounding properties. Non-compliance should cause the city to have the necessary maintenance done and to assess the cost as a benefit tax. New zoning laws should be wisely drawn, complete, and rigidly enforced when applied to undeveloped land; when superimposed on established uses, their practical application should govern the extent to which zoning theory can be used. Nonconforming uses which adversely affect neighborhood values should be made to conform or be removed as quickly as possible instead of allowing them to continue their depreciating effect for many years in the future when their eventual removal may become unnecessary.

A lot has been written recently about inequalities among men as if this condition had just developed, although it has existed since the beginning of mankind. Likewise, it is human nature that man seeks to better his economic status so that he can enjoy all of the comforts and conveniences he can afford and also to choose his associates and friends and place of abode in a neighborhood which is compatible racially, socially, culturally and economically. We recently read a release by the National Resources Planning Board which recommended that our neighborhoods be rebuilt to require a co-mingling of all groups regardless of race, nationality and economic status. Our appraisal experience and study of real estate trends would indicate that in neighborhood projects so planned, economic failure would be certain. In practically all American cities, the Negro has been fairly well segregated, with benefit to both the Negro and the white races.

It is well recognized by the appraiser that like use creates the greatest real estate values in both business or residential properties. Retail outlets of similar type and price class naturally gravitate together and the highest residential values are attained when compatible racial and economic groups are present. Those trends which cause a co-mingling or mixture of adverse influences are a basic cause of loss of real estate values and blight.

A. B. Kissack
A.B. Kissack, M.A.I.



APPRAISAL BULLETIN

10

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

A MANSION PASSES

CAUSAL INFLUENCES

The importance of accrued depreciation in the appraisal of real properties cannot be over-stressed. In Bulletin 2 an attempt was made to classify those elements of depreciation which permanently impair the full usefulness of properties and thereby cause a permanent loss in value. The inadequacy of that brief outline is realized and no attempt was then made to indicate how the appraiser could determine just what adverse influences impair a particular property or how to measure the extent of the impairment caused by each influence.

It is evident that depreciation bears no fixed relation to the age of the property. So many items which cause depreciation bear no relation whatever to age, such as inaccessibility, incompatible environment, inadequate land use, non-use construction, undesirable design, etc., which may occur in new and modern properties. We have found it quite helpful as a matter of routine to consider each property appraised in its relation to each of the following causes of depreciation which are most commonly encountered in all types of properties.

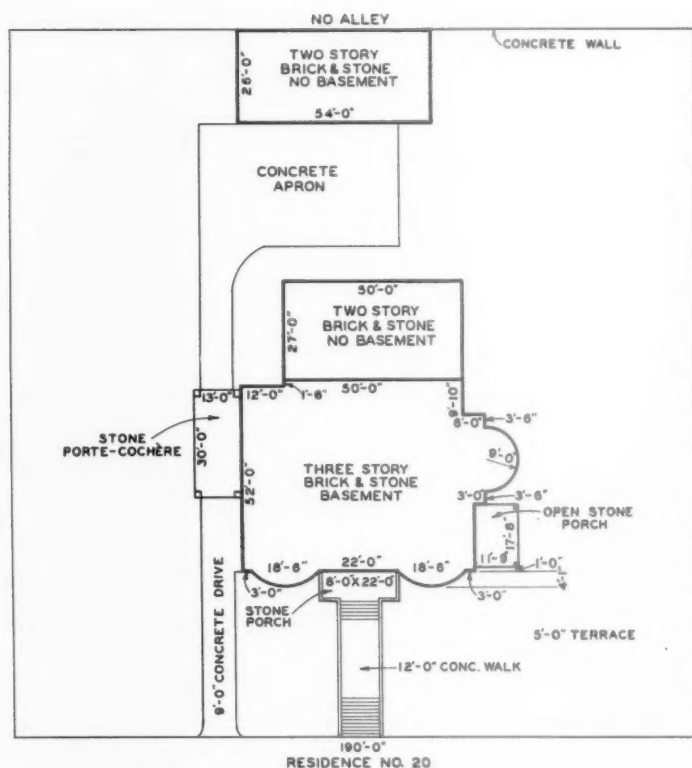
1. Deterioration - normal wear and tear and structural faults.
2. Obsolescence - in style, design, functional.
3. Non-use construction.
4. Undesirable layout.
5. Inadequate land use.
6. Incompatible environment.
7. Inaccessibility.
8. Restrictions of use by deed, zoning or lease.

Every property appraised should be studied and tested for each of these causes of depreciation. It may be quite helpful in considering a single cause to assume for the moment that the property was not affected by any other influences causing depreciation. In some cases, estimates of loss in value can be made with reasonable accuracy. At best, ascribing the causes of depreciation and weighing the extent of each depends upon the knowledge and experience of the appraiser and the care he exercises in his analysis and studies.

In 1942 we were consulted about a mansion-type residence which had been built in 1902 in an exclusive and restricted section of St. Louis. This subdivision was restricted to development exclusively for single-family dwellings on lots having not less than 100 foot frontage. These restrictions could not be changed unless consent was given by all of the property owners in the subdivision. Forty years ago this subdivision and the street to the south were



PHOTOGRAPH 1931



PLOT LAYOUT

three first floor rooms. An elaborate staircase from first to second floors was of carved quarter-sawed oak. Marble and tile floors and walls in bath rooms and floors of first floor and master bedrooms were of parquet oak. In fact, the entire improvements were built of the best in materials and workmanship.

We could secure no data on the cost of construction in 1902; our estimate of MAXIMUM VALUE in July 1942 was as follows:

quite exclusive and dwellings were built at costs ranging from \$75,000 to \$150,000, by the extremely wealthy families of St. Louis. It was then, as it is today, human nature for men of wealth to build palaces and mansions in which to live on a scale of grandeur and luxury and with which to tickle their vanity and to display their own self-importance. Most of the properties were of three stories and contained many rooms, generally with a ball-room on the third floor. These large dwellings were built on comparatively small lots with a forty foot building line.

The property under consideration had a lot frontage of 190'-0" and a depth of 195'-0". The residence proper was of two and three stories with basement under the three story portion and contained sixteen rooms and six baths. At the rear, a garage converted from the original stable was two stories in height with three rooms and bath on the second floor (see photograph and sketch to the left). From the photograph, the palatial nature of this residence is indicated. The outer walls of both the residence proper and the garage are faced with cut limestone; on the residence, the highly ornamental and sculptural work, including marble columns, is of high quality and costly. The roof is constructed of glazed shale tile; downspouts are of cast iron within the outer walls. Interior construction follows the same exterior grandeur; carved marble mantels and moulded plaster walls were especially attractive; matched panels of burl-walnut covered the walls of

Value of Land - 190' @ \$30.00		\$ 5,700.00
Improvements		
Walks and Drives	\$ 455.00	
Residence, 207,500 cu. ft. @ 75¢	155,300.00	
Porches, porte-cochere, etc.	11,270.00	
Garage, 35,100 cu. ft. @ 32¢	11,250.00	
Architect's fees, int. & taxes during construction	15,500.00	
Reproduction Cost of Improvements		193,775.00
MAXIMUM VALUE - July 1942		<u>\$199,475.00</u>

On that date, our investigation revealed that the property under consideration was foreclosed by the present owner in 1931 and that in 1933 it was vacated by the tenant and had remained vacant since that time. In 1931 the property was in a splendid state of repair and deterioration had been slight. During the nine years it was vacant, the property was neglected. The steam heating system was improperly drained and freezing had caused considerable damage; one of the downspouts became clogged and freezing weather caused some wall damage; termites had entered the building and caused further damage; besides, exterior repair and painting and interior decoration had been neglected. It was estimated that to make the necessary repairs to restore the property to its 1931 condition would cost about \$15,000.

During 1942 the owner had received bids for its demolition which ran between \$2,000 and \$2,500, the contractor to retain all materials salvaged.

100% DEPRECIATION

When the owner received an offer to purchase the entire property (land and improvements) at a price below \$4,000, our advice to him was to accept it, which merely confirmed the owner's conclusion. The property is now in the process of demolition. This conclusion is self-evident when it is realized that the estimated cost of rehabilitating the property is greater than the sale prices of eleven similar properties in this subdivision from 1935 to 1940, all of which were below \$10,000 and six of which were below \$7,500, with one as low as \$2,500. All of the properties sold during this period were in fair or good condition and in much better shape than the property under consideration. When the owner inquired as to the causes of the 100% depreciation suffered by this property, it was found exceptionally difficult to separate the several causes which produced the combined result and to measure the part played by each depreciating influence.

In arriving at an opinion, the following analysis and approximation was made of the portion applicable to each cause. We eliminated from consideration causes (5), inadequate land use, and (7), inaccessibility, because in our opinion the improvements did not lose value from these causes.

(1) Deterioration - This property was so substantially and well constructed that it is estimated that an annual expenditure of \$1,750 for maintenance and repair which included replacements would maintain the property in excellent condition. In 1931 the property was reported in a splendid condition and in comparison with new construction at that time it is believed that deterioration would not be more than 10% or \$19,000. Deterioration has been determined as follows:

Normal Wear and Tear in 1931	\$19,000	
Excessive Wear and Tear 1932 to 1942	15,000	
Total Deterioration	<u>\$34,000</u>	or 17.5%

(2) Obsolescence - We have considered only the loss in value due to the out-of-dateness in design, construction and equipment, both economic and functional, which are classed as obsolescence. The inadequate lot size as a setting for this dwelling; third floor space; eleven foot ceiling heights; obsolete fixtures in bathrooms and obsolete heating, plumbing and electric systems have been estimated as an obsolescence loss of \$64,775 or 33.4%.

(3) Non-Use Construction - By far the greatest depreciation influence is the excessive construction cost in quality and size over and above that necessary for comfortable and gracious living. This non-use cost represented value to the particular owner who built the property (see Bulletin 7). New and modern properties built on a similar scale as the property under consideration suffer from like losses in value. In 1931 the annual cost of ownership, exclusive of a return on the investment and those excessive expenses of household, servants, etc., amounted to about \$4,800, made up of property and subdivision taxes, \$1,500; insurance, \$250; maintenance and repair, \$1,750; heating expense, \$1,300. This high cost of ownership effectively prevents standards of living of residents in this subdivision from dropping to low levels as only those families with large incomes could afford to live in this subdivision. We have estimated the loss in value from this cause at \$95,000 or 49.1%.

(4) Undesirable Layout; and (6) Incompatible Environment - For the above reason, no deduction has been made for incompatible environment, although the standards of living of families in this subdivision are now greatly below the standards of the original owners. While the site size is now considered an improper setting for a residence of this size and quality located in Metropolitan St. Louis, the small loss in value from this cause is included in obsolescence.

(8) Restrictions - There is no loss in value due to restrictions by zoning and deed to single family use. The only other use to which these residences could be put is for rooming house purposes. Again, the high cost of ownership would preclude renting the properties in this subdivision to rooming house operators, if the present restrictions could be removed. A summary of loss in value (depreciation) is as follows:

Deterioration	17.5%	\$ 34,000
Obsolescence	33.4%	64,775
Unsalable Whims	49.1%	95,000
Total	100.0%	\$193,775

Deducting this loss in value (depreciation) from MAXIMUM VALUE gives the VALUE of the property entirely in the land, or \$5,700. Deducting from this the cost of demolition of, say, \$2,000 leaves \$3,700, which approximates the price for which the property was sold. Quite recently the City of St. Louis was offered a similar residence, perhaps on a somewhat grander scale, to be used as the Mayor's residence. The City wisely refused the gift.

A. B. Kissack
A.B. Kissack, M.A.I.



APPRAISAL BULLETIN

11

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

AN APPRAISAL OF THE EFFECTS OF GOVERNMENT SUBSIDY

IT is apparent that post-war planning is now under consideration in many of our metropolitan cities. Master plans have been drawn in some cities and new zoning laws are being formulated. In some cases, state laws have been passed authorizing the formation of urban redevelopment corporations and granting them the right of eminent domain to condemn real estate for rebuilding neighborhoods on new and modern lines. The purpose of such planning is, naturally, worthy. To remove the obsolescence of horse and buggy days and to provide new and modern residential and industrial properties to replace old structures which are considered obsolete and unsuited for habitation or for profitable production are objectives with which no one could disagree.

There can be no question that the process of decay with depreciating values is a reality and generally present in all metropolitan cities. The deterioration and obsolescence which accrue with time and use are natural processes and vary in degree within all of the older sections of our cities. In some sections, blight is slightly advanced; in others blight has deepened to such an extent that a considerable part of the values of properties has been lost. In the extremely old sections, excessive obsolescence exists and properties have lost most of their values. The process of deepening blight is continuous with time and progress, although depressions tend to hasten blight and booms tend to retard it.

The decline in real estate values as deterioration and obsolescence accrue has long been recognized by informed persons. That real estate has a limited useful life and that investments should be written off by annual deductions for depreciation is common business practice. In spite of this knowledge, in the majority of appraisals made today capitalizing real estate net income as a perpetuity is common and in the recent past, mortgagees failed to amortize loans under the mistaken belief that land values would appreciate faster than buildings would depreciate. They were misled by the assumption that population growth would provide a higher or more concentrated use of the land by the time the original improvements became inadequate.

As stressed in a previous bulletin, the values of residential properties depend not upon the cost to construct them but upon the ability of tenants to pay rent. The economic status of families renting dwellings in any city will be the controlling factor in establishing the rents and values of its residential properties. The wide variation in family income is quite fortunate for residential properties because as properties decline in desirability from accrued depreciation, there are families of lower income available to occupy them at the lower rent. It was also stressed that there is only a very small percentage of families in any metropolitan city which are able to pay suffi-

cient rent to provide a proper return on the cost of new residential construction.

Urban redevelopment has been approached from the standpoint of preserving the inner city from further decline and attempting to recentralize population in the inner city, or purely from the social angle that the government owes better housing to urban dwellers, especially to the soldiers when they return from overseas. We have been unable to find any approach from the standpoint of the financial soundness of such redevelopment or in regard to the price which owners of existing and competing properties must pay in the form of losses in property values from government competition or in the loss in those rights now surrounding the private ownership of real estate.

From our analyses and studies, it is our conclusion that private industry by itself cannot undertake urban redevelopment on a profitable basis even if the right of eminent domain is granted to assemble the land for that purpose. If this conclusion is correct, then development corporations must seek some form of subsidy from the municipal, State or Federal Government besides the protection by law from competition by owners of land in the outlying sections.

It is indicated that urban redevelopment of the inner city, with few exceptions, must provide more dwelling units per acre than the dwelling units it displaces. It is also self-evident that the rents of the new dwelling units must be greatly in excess of the rents that the displaced tenants paid in the old and obsolete properties. Finding suitable quarters for the displaced tenants at rents they can afford to pay presents one of the greatest problems which is usually forgotten in all city planning. Moving them to a better district than the one from which they were displaced does not increase their ability to pay rent but would tend to lower values and deepen the blight in the better districts. At the same time tenants with insufficient income are displaced, prospective tenants for the new units must be drawn from other sections of the inner city, from the outlying sections or from in-migrants to the city. It has been suggested that displaced tenants will be housed in other highly subsidized housing or in new public housing.

The fact that more units must be built than the number displaced by the new construction will tend to create a surplus of dwelling units which will cause lower rents and values of all residential properties. Shifting tenants from one section of the city to another section will not change this created city surplus nor change the depressing effect which surpluses always create. The only justification for creating a surplus of dwelling units would be the certain expectation of city growth to absorb it. A majority of the metropolitan cities in America are reaching a mature growth. The rate of increase has been declining and expected future growth will be at a slow pace for most of them. Many cities whose spectacular growth during the past two years is due to war contracts cannot expect to retain all of their gains. Most of them will experience an exodus of a substantial part of this increase when the transition period from a war to a peace economy arrives. Many such cities will find a surplus of dwelling units from this cause without further increasing this surplus by urban redevelopment. It is also reasonable to assume that Congress will not be inclined to discourage home ownership and will continue the policy of favoring the home owner in his income taxes by allowing a deduction for property taxes and mortgage interest without including the rental value of the owned home in gross income. This is in effect a subsidy to home owners which allows the deduction of a part of property expense (taxes) and a part of the

cost of ownership (mortgage interest) and does not require the inclusion of the benefits (rental value) as part of gross income. This subsidy is not given the owner who rents his house to another or to the renter who rents his house from another. In England the estimated rental value as determined by the Assessor is included in gross income for income tax purposes.

At this time it also appears that FHA insured mortgages on small new homes with low down payment and a long amortization period will be continued in the outlying section during the post-war period. This government policy is a decentralizing influence and will be in direct competition with redevelopment in the inner city. Since 1937 when this act was designed primarily to stimulate the construction industry, vacancies in older residential properties which were not favored by this financing, were not absorbed and rents and values of older properties remained sluggish.

In our opinion urban redevelopment of the inner city will not proceed at a rapid pace in the post-war period if the laws of supply and demand are operative. We cannot create a large surplus of residential properties in a free or in a managed economy without creating a real estate depression with lower rents and values which alone cannot stimulate demand. We feel that large-scale urban redevelopment for most metropolitan cities is wishful thinking. It may be that we are missing the boat and fail to realize the extent of socialization which this country will undergo after the war. It appears quite probable that Congress will appropriate billions for public works as cushion employment in the transition period and it is also possible in this emergency that funds will be designated for assisting urban redevelopment to remove the blight in the inner city of all urban centers. However, the trend is now turning away from a paternal government which can direct our lives and fortunes and away from an attitude that it is a sin to be successful and make profits.

There are forms of government subsidy and control which have proved of benefit to the general public. Shipping subsidies, land grants to pioneering railroads, Federal road aid, etc., and the supervision of public utilities and other monopolistic enterprises have long been a part of our established governmental policy. To assist projects for the benefit of all and to prevent exploitation from monopoly where there is no competition promotes the general welfare. Before the present administration, the government acted more as an umpire or the agency of the people to maintain equal opportunity and to prevent unfair competition.

There is no monopoly in the ownership of real estate; in fact, its ownership is so broad that it covers a large part of the population. To subsidize any part of its construction through government financing, rent doles or tax exemptions, even for the worthy cause of urban redevelopment, immediately creates unfair competition with privately owned unsubsidized properties and tends to lower the values of such properties. Private enterprise in any endeavor and government subsidy cannot compete on a fair basis. They are opposites in concept; the former is motivated entirely by profit and the latter by social welfare regardless of profit. In our opinion there can be no working arrangements or compromise between the two.

If the housing in urban redevelopment must be subsidized as we feel sure it must be, then all competing properties should likewise be subsidized, or the competing properties will suffer further depreciation. Mortgagees with

loans in the inner city on properties which are unsubsidized will find their loans less secure or jeopardized. There will be many owners of properties in the inner city and also mortgagees holding loans on them who will favor redevelopment because they feel that through condemnation they will be bailed out and their investments saved which otherwise appear in jeopardy. This is a natural feeling, based on immediate self-preservation. Likewise, some of the larger material dealers and construction labor will favor urban redevelopment as a means of increasing business and employment. All interests who will benefit from condemnation and construction will naturally be inclined to follow along with the city planners and public housers. A large number of tenant families who want to live in new and better housing for the same or less rent than they are paying in older and depreciated properties will swell the clamor and propaganda for urban redevelopment. The landlords who have relatively few votes will face a hostile attitude on the part of a social-minded government. This is apparent from rent control which unfairly holds rents at low levels in comparison with every other living cost and with family incomes. There are not enough votes for Congress to give real estate a square deal.

We believe that the only attitude that private industry can take is to insist that urban redevelopment stand on its own feet without subsidization and give full cooperation for its successful completion on this basis. Otherwise, it should oppose it by every means at its command on the grounds that over the long period the socialization of residential real estate will cause the strangulation of private enterprise in that field.

In principle, we are not in favor of public housing which is highly subsidized. The fact that tenants are selected from among those families in the lower income brackets is further objectionable. The only logical justification for public housing projects which are highly subsidized by municipal, State and Federal Governments is that they are eleemosynary institutions to house those families whose inefficiency from physical or mental deficiencies prevents them from providing for themselves. The least fortunate of these unfortunate families should be provided for first and not those selectees who can qualify under government rules. If in concept public housing projects are an economic corrective, families residing in them should be under constant regulation and supervision with every assistance given them to increase their earning capabilities. It should be made a happy occasion when families can cease being wards of the government, can leave public housing and again become free American citizens.

In an economy of private initiative and ownership and free competitive markets, the profitableness of real estate determines its desirability and value. Until the people are willing to replace this economy with one in which social welfare or any other reason regardless of profit is the underlying motive, the partial socialization of real estate should be opposed. We cannot have both economies at the same time without disaster to private enterprise. It is the function of the appraiser to weigh the effects of real estate trends but he should be more vitally concerned with the changes in our economy which may destroy real estate values as we know them.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

12

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. - Saint Louis

Roy Wenzlick
Editor

COSTS AND RENTS OF MULTIPLE DWELLINGS

POPULATION CONCENTRATION Whenever a commodity is produced, a building is built or any plan is carried out which is contrary to the exacting requirements of demand, economic disaster surely follows. Demand is dual in nature and each of its elements is entirely different from the other. The first element springs from the desires of man, many of them elemental, based on human nature, but many are broadened and multiplied through education; the second element of demand concerns the ability of man to gratify his desires, which in turn depends upon his earning capacity accompanied by employment and hard work. When either of these elements is lacking effective demand does not exist.

There are many basic desires of man involved in the housing field. The desires for shelter from inclement weather and a place with privacy and safety in which man can establish a home and rear his family in a location that is convenient to his place of employment and other social activities are a few of the elemental desires for residential properties. The log cabin gratified these desires for the pioneer and farmer in the early days. The idea of many dwellings in one building is purely an urban development. The multiple dwelling was a necessity in early days and was built to meet the requirements of demand. It was the logical type because it was economic to build with a minimum of land used and less cost of improvements per dwelling than any other type of residential property.

We find that multiple dwellings were built in ancient and medieval cities where safety required the city to be enclosed in a defense wall. Population was concentrated within these walls and towers of one room to a floor were built to a height equivalent to a ten- to twelve-story walk-up tenement. The desire for safety outweighed the inconvenience of these congested living conditions and excessive heights. Likewise in early American cities their rapid growth before rapid transportation necessitated population to be concentrated in small areas because the desire to be close to factories, shops and other social activities outweighed the inconveniences of multi-story walk-up tenements.

Naturally, high land values were created by a favorable location due to limited transportation facilities and necessitated concentration of population. In both the walled city and early American cities concentration with high land values was due to demand and not because greedy absentee landlords wanted to force families to live in crowded and inconvenient dwellings. Because inadequate transportation centralized population, adequate and rapid transportation will continue to decentralize it. (See "As I See It" Bulletin dated December 1942.)

MULTIPLE DWELLINGS

The multiple dwelling, wherever its location and the demand warrant its construction, possesses several advantages over the single-family dwelling from the standpoint of the low amount of land used per family and the lower construction cost per dwelling unit. The single-family dwelling is the least efficient of all types of residential properties. The apartment, which became popular about the turn of the century in almost all metropolitan cities, is a multiple-dwelling type which includes its distinguishing feature of a common heating plant for heating all units, besides other services such as janitor service, hot and cold water and in some cases ice box and stove. It was only revolutionary in that former household expenses were furnished and included in the rent.

Built originally in the better neighborhoods, the added services of apartment properties complied with the demand from families in the higher income brackets. Containing five or more full rooms, it was found that more than a three-story walk-up type would be too inconvenient to maintain demand, although in the Bronx a substantial part of its apartments are six-story walk-ups, built forty years ago. It is believed that nowhere else in the United States would the three upper floors command rents sufficient to prevent an operating loss.

The trend in apartment properties is to reduce the size of the apartments in order to reach those families in the middle class. Three- and four-room efficiencies are the popular type and more suited to the demand of the present average-sized family. The tendency is to include more and more services such as gas and electricity and furniture and furnishings and in the apartment hotel to include practically every item of household operations such as telephone, linens, dishes and silverware, maid service, etc. Apartment enterprise is becoming an important factor in modern apartments.

The apartment gratifies the demand of a large part of the families in all metropolitan cities, although the percentage varies greatly among cities. It gratifies the desire for convenience and comforts for those persons who by reason of attitude and temperament are either unsuited or who are unable to afford home ownership and to the great number of families who, on account of age, employment or unstable residence, cannot use a single dwelling.

The single-family dwelling is best adapted for owner occupancy; it is not considered a good rental property. On the other hand, apartment properties are purely rental properties where the sole consideration for their construction are the investment possibilities. Less than six families in an apartment property tend to lower investment possibilities. It appears that apartment properties are the logical choice for neighborhood redevelopment of the blighted inner city of all metropolitan cities. Already a bill has been submitted to Congress to permit cities to borrow long-term government funds at low interest rates with which to purchase blighted areas, which will then be leased or sold to private enterprise for neighborhood redevelopment according to plan and under the supervision of a Federal agency. This is one of the first steps in the subsidization of real estate for the post-war period. It is believed that others will be necessary to make such redevelopments economically sound. (See Appraisal Bulletins 9 and 11, March and May 1943.)

It has been our experience that the relationship of construction cost to land cost of a new, modern single-family dwelling averages about four to one.

A \$6,000 bungalow will have a building cost of \$4,800 and a land cost of \$1,200. This appears to be a sound economic ratio between building and land. Of course, many single dwellings vary from this ratio; in the older sections of all cities where congestion was essential a much higher ratio is found, but in most cities such high ratios are a depreciating influence. The only place in America where this ratio is reversed (1 to 2.5) is in Manhattan, New York. This uneconomic condition is due to congestion and high land values. This ratio is indicated by the assessed values (1940) on all single dwellings in Manhattan, which may not represent the true economic picture. This adverse ratio does not exist in the other boroughs of New York City.

It is also our experience that the ratio of the cost of improvements to the cost of land in new apartment properties averages about 8 to 1. This ratio represents a proper economic relation of improvements to land in most metropolitan cities. While the ratio of 8 to 1 varies somewhat with the number of units built, the construction quality, and the location, it does indicate that the cost of construction is the controlling factor in establishing rents in apartment properties and that land has only a minor influence. This is well illustrated in Metropolitan's Parkchester in the Bronx, New York City. This project represents a modern housing project, well located, well designed and well constructed, with every saving possible in mass production with modern construction technique. It is not intended to imply that a like project on such a massive scale could be built elsewhere, unless a like demand for such apartments existed. The principles involved are believed the same for all metropolitan cities. The following rough analysis is made from figures published by Metropolitan Life Insurance Company in their advertising matter.

Cost of land (\$31,000 per acre without municipal improvements)	\$ 4,000,000.00
Cost of improvements (12,242 units)	46,000,000.00
Cost of project	<u>\$50,000,000.00</u>
Cost of land per apartment unit	\$ 330.00
Cost of improvements (average $3\frac{1}{2}$ rooms)	3,770.00
Total cost per average unit	<u>\$4,100.00</u>

The monthly rent of an average $3\frac{1}{2}$ -room unit @ \$13.00 is \$45.50, including gas and electricity. This rent is broken down as follows:

Assumed 5% return on cost of land (.05 x 330)	\$ 1.38
Assumed 5% return on cost of improvements and an economic life of 40 years ($\$3,770 \div 17.16 \div 12$)	18.30
Assumed 5% reserve for vacancy (5% x \$45.50)	2.27
Assumed property expenses	23.55
Total rent	<u>\$45.50</u>

This project was built by private enterprise without subsidy of any kind. A return of 5% was assumed, which is below a proper capitalization rate for this type of property. In fact, it was admitted by the owner that rents were below the market, that no vacancy existed, that applicants exceeded by several times the apartments available, and that a higher rent could be secured.

It is of especial interest that the part of the monthly rent representing a return on the land was \$1.38, or about 3% of the total rent. This would indicate that if the land had been given the owner without cost and the owner

EFFECT OF COST ON RENT

passed this saving to the tenant, the rent of the average apartment could have been reduced to \$44.12. On the other hand, if the cost of land had been doubled, costing \$62,000 per acre instead of \$31,000, the rent of the average apartment would have to be increased to \$46.88. If the rate of return were increased, or if the cost of construction were increased, or if fewer than the present ninety-five families per acre were housed, then rents would have to be increased accordingly. The minor influence of land cost on rents in apartment projects is usually not realized and is contrary to popular opinion.

The return on cost of construction and its depreciation have a major influence on rents which amounts to \$18.30 per month or about 40% of the total monthly rent as shown in the foregoing analysis. It is self-evident that an increase in construction cost would increase apartment rents much more than a like increase in the cost of the land. In fact, a 10% increase in construction cost would cause a greater increase in rents than a 100% increase in cost of land acquisition (\$1.83 against \$1.38).

This fact is very important in post-war planning if neighborhood redevelopment takes the form of large multiple dwelling projects and especially if inflation occurs as is so frequently predicted. Inflation is reflected quickly in increased wages and material prices. This would directly affect not only cost of construction but many items of property expenses, such as maintenance and repair and most other operating expenses. Inflation would have relatively small effect on the older properties, whose value must be included in cost of land acquisition. If in the post-war period inflation increased construction cost 30% above the cost when Parkchester was built, a not unreasonable assumption, it is estimated that rents in a like project would have to be increased \$10.00 per month, provided the low rate of return of 5% on the investment were continued.

Because of the fact that the cost of land has only a minor influence on rents and that construction costs, depreciation and operating expenses determine more than 95% of rents, it would appear that whether the apartment were built in the inner or outer city would make only a slight difference in the rent requirements to make the property economically sound. Location must be selected which in its relative position and environment will gratify the greatest demand from families able to pay the required rent. It is generally recognized that rapid transportation has greatly reduced the difference between locations of residential properties from the standpoint of accessibility and that the controlling influences of location are freedom from annoying influences and compatibility of environment of a social, racial and economic nature.

All families already possess the desire to live in new and modern housing, whether in apartments or single-family dwellings; however, only a small portion of them possess the ability to pay the required rent in the former or to assume the cost of ownership in the latter. Whatever the purpose of new residential construction, whether to remove obsolescence in the inner city or to develop land in the outlying sections, the type, class and extent of new construction must be governed not by desire but by the ability to gratify it.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

13

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

THE LABOR OF MANAGEMENT

MANAGEMENT AND VALUE

There are very few things found in nature which are available for man's use without the expenditure of labor. Of course, the so-called free goods such as air, sunshine, rain, etc., have no economic significance because of their unlimited abundance. Natural resources become wealth only as labor, intelligently directed, creates economic utility and monetary value. The pioneer by his labor in clearing, drainage, fencing, well digging, etc., created the wealth represented by the added farm value. This capital wealth created in the farm resulted basically from the labor which was expended upon it. As was customary in those days, the owner and his family did the work themselves without paying wages and no account of the long hours of labor was kept. The value created was not necessarily in direct proportion to the labor expended on the land or its money equivalent but would depend upon the productivity of the soil and the values of comparable properties at the time.

Labor is defined as both the physical and mental exertion expended in any task. In early days a large part of the labor required was physical effort, where the laborer was trained in the use of hand tools and only slight mental exertion was required of him; many trades required not only physical labor but special knowledge, experience, training and skill in the tasks he must perform. Since the machine has become an important aid in creating wealth, the demand for common or physical labor has greatly declined. In all modern production enterprises of farm and industrial endeavors, the machine with skilled operators is replacing the need for physical labor of man and animal. The use of the machine in mass production and the assembly line have revolutionized production processes, permitting savings in man-hours which result in lower prices and higher standards of living. Distribution enterprises, with the exception of some food establishments, have not been favored with the same savings as production.

In all types of enterprise, management is the most essential factor in successful operation. Americans can be justly proud of the production records of private enterprise in our present war effort, which has surprised the world, especially our enemies. It is the "know how" of management which has been able to increase constantly the quantities of war materials and equipment produced, at the same time lowering their costs, although during the emergency of war costs are not a controlling influence.

Management, in its last analysis, is basically mental labor. It is the most important function in all private enterprise because private enterprise does not operate automatically. From the peanut vendor to the industrial gi-

ant, management must assume the responsibility for successful operations. The function of management is not only to direct and harmonize labor relations and conserve capital, but it must operate its enterprise successfully and profitably by balancing the divergent viewpoints of consumer markets, labor and capital. It is human nature that the consumer wants the maximum value for the minimum price, that labor wants the maximum wages for the minimum hours of work and that capital wants the maximum return on the minimum capital invested. It is said that there is always room at the top in all large business enterprises for those who possess the qualifications to assume the responsibility of successful management. Certainly, business experience and a specialized knowledge of the commodity produced, its markets and competition and all phases of its production, are qualifications of management in all business enterprise.

That the cost of management is a part of operation expense is generally understood, especially when management is employed and paid for by the owner. However, when enterprise is operated by the owner and no definite compensation is paid for management, there is considerable confusion in the minds of many concerning management costs and the necessity of including them as part of costs of operation before a return to capital can be estimated. This is well illustrated in farm operations where the owner's entire time is expended in production and management of the farm, although no compensation is allowed for this time and no accounts kept of it. It is a common error to deduct the actual money spent in production from receipts to secure false net return from the farm.

This same erroneous method is often followed in real estate, especially with investment properties, where the sole reason for their ownership is the income received. On several occasions we have examined the appraisal of small multi-unit dwelling properties, where no management cost was used because the owner occupied one of the units and managed the property himself. He made no charges for his services and his accounts showed no management expense. Apparently the appraiser assumed that because the owner lived on the premises he was handy and could spare the time to manage the property; therefore, management labor was donated. Of course, such an assumption is unsound and illogical. If it is correct that management is an essential part in the operation of real estate, it would appear ridiculous to assume that the labor of management is free. It would follow upon the same reasoning that, if the owner cut the grass and did other janitorial work or took care of repairs and decorating, etc., doing such work in his spare time, the cost of these items could be saved and real estate net income and value increased.

ACTUAL AND ESTIMATED
OPERATING COSTS

In a recent tax case before the Supreme Court of Ohio involving an alleged over-assessment of an eight-unit flat or tenement located in Cleveland, Ohio, the brief of the appellee claimed: "He (the appellant's appraiser) estimated and allowed five per cent of gross rent for management charges, although there was no testimony that the owner was deducting such charges in her operating expenses." The management allowance amounted to about \$130.00 in this case. This argument by the appellee did not question that the property was well managed but intimated that the way the owner kept her books determined whether or not management charges should be included in the property expenses in finding the net income applicable to the real estate. In effect, if the owner did not make the deduction for management charges in her accounts, then they should be excluded and the net income in-

creased \$130.00, which would be reflected in an increased VALUE of the property. Such reasoning is fantastic and indicates, to say the least, a lack of understanding of real estate net income on the part of the appellant's attorney and, perhaps, the Court which upheld his argument.

Real estate net income before depreciation, interest and amortization, is that return which is estimated after all costs, expenses and charges necessary in the operation of the property are deducted from the effective gross rental income. This estimated net return applicable to the real estate is the basis for applying a capitalization process from which a capital sum of money is calculated which represents the economic or investment value of the property. In modern appraisal procedure, this capitalized sum is designated VALUE without qualifying prefixes. It is defined sometimes as the justified and warranted price which willing and informed buyers and sellers would establish in a fair market, using ordinary business prudence in negotiating the sale.

In the foregoing Cleveland tax case, the opinion of the court said "when considering net income as a factor in establishing the true value of income producing property, operating expenses estimated by a witness need not be given the same weight as actual expense." The criticism of the appellant's appraisal in the argument by the appellee was that a management charge of 5% was estimated, which has been previously discussed; a deduction of 5% for vacancies was estimated and maintenance and repair expenses were estimated without testimony showing these expenses actually incurred. While it is unfortunate that such an unqualified opinion should be made the law in Ohio, it is not entirely unreasonable. It should be common practice for the appraiser to use actual property expenses whenever they are available and when in the opinion of the appraiser the actual expenses represent the amount to properly operate the property and to conserve the investment. If possible, actual property expenses for several previous years should be secured to establish a normal or average expense. Whenever any item of expense is estimated at an amount different from the actual money spent, the reason for the change should be explained.

It should be self-evident that many items of expense vary from year to year and that the actual money expended in any single year would not be the true expense. Many items of maintenance and repair are done, not uniformly each year but at periods varying from two to twenty years. For example, exterior painting is necessary every three to four years; interior decorating from two to five years, depending on the rental class of the property; many roofs need replacing every ten years and other items of building and equipment are repaired or maintained only occasionally. We have appraised properties where the actual expenses were merely a nominal amount in a certain year while in another year excessive maintenance costs were experienced.

Likewise, heating costs vary from year to year depending on the weather. Some mild years with subnormal degree days require a subnormal amount of fuel; in other years, severe weather with above normal degree days requires an excessive amount of fuel. Surely the law of Ohio does not require more weight be given the actual expense under these circumstances than it would to an intelligent estimate of normal annual expenses for these items by any qualified person.

The same reasoning applies to a deduction from gross rental income for vacancies. It is general knowledge that multi-unit properties are rarely fa-

vored with constant 100% occupancy throughout their economic life, but that losses in gross rents occur from unused space, losses in collections, etc., which vary from year to year with changing economic conditions. The appraiser must estimate the normal expected loss from these causes.

APPRAISAL OF MANAGEMENT COST

It has been stressed that management is an essential part of all enterprise operations and that, therefore, without management enterprise would fail and economic chaos result. Management is an essential part in creating the VALUE of real estate. Generally more competent management is found in the larger and newer properties than in the smaller and older properties. It is the function of management to secure the maximum effective gross income over a long period which is commensurate with the property itself, its location and environment, and to operate the property at the minimum expenses commensurate with its type, age and rental class, thereby creating the maximum net income and VALUE possible, while conserving the investment committed to its charge. The proper selection of tenancy and maintenance of property and services preserve property reputation. Undesirable and incompatible tenancy is usually the beginning of declining reputation and values.

Good, average and poor management will be reflected in the value appraised. The appraiser must call his shots as he sees them. The appraisal report should include whether management is considered competent and adequate, the type of tenancy and property reputation, the condition of the property, the necessary repairs to restore the property and prevent further rapid deterioration. Above all, the appraiser's estimates must be based upon his experience with many properties and upon sound economic principles.

The appraiser must avoid the pitfall of assuming that essential and constructive labor of management or any other property operation can be done without cost because the owner does the work himself and does not pay himself compensation. This is unsound appraisal practice and would be on a parity with an estimate of the replacement cost of a house, built by an owner and his family without paying wages, at only a fraction of the replacement cost of an identical house built by a contractor. When essential and constructive labor is performed on any task, value is created regardless of whether compensation for such labor is paid or accurate accounts of the work done are kept. The cost of such labor is measured by the costs usual and customary for similar work in the place where the work is done.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

14

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

PROPERTY EXPENSES

ONE VALUE

It has been stressed in former bulletins that regardless of the approach, the appraiser can arrive at only one monetary sum which represents his conclusion as to the VALUE of a particular property. When the appraiser uses the three accepted methods - cost, income and comparison - he should arrive at a single value which represents the economic significance of the property. There exists an apparent misunderstanding or confusion concerning this principle of appraising among most owners and prospective purchasers, among many attorneys and Courts and among some appraisers. The confusion is well illustrated by the testimony of an appraiser in a midwestern city who, in appraising a small income property, found a "physical value" of \$18,500 (reproduction cost less depreciation), an "economic value" of \$10,500 (capitalized income), and a "market value" of \$15,000 (comparison). We have no doubt that the confusion in the mind of the witness was created in the mind of the Court.

In all investment properties whose sole cause for ownership is the income which can be received, use is directly measurable in dollar income and the net income which can be reasonably expected from the property during its remaining useful life is the key to its VALUE. Net income expressed in dollars is the common denominator of all income producing properties and when properly appraised, the property appraised can be reduced to an annual sum to be received for a specified number of years. It is evident that the proper determination of the effective net income is one of the most important operations in the appraisal of income properties.

In Bulletins #4 and #5 the income approach has been discussed in some detail. It is apparent that the actual net income derived from a property at any particular time provides only a basis from which the expected net income can be estimated. This is evident from the fact that actual gross income may vary above or below the effective gross income which can be reasonably expected from the property during its remaining useful life. Likewise, actual property expenses may vary above or below the estimated average expenses of a matured property. It has been our experience that it is necessary to estimate the effective gross income and the average property expenses in finding property net income for almost all investment properties, although the actual income and expense when available should be used whenever proper to do so.

In appraising by the income approach, there should be some uniformity among qualified appraisers in estimating the net income which can reasonably be expected from the property to be appraised. Only by such means can the wide variations in the opinions of VALUE among competent appraisers be narrowed within reasonable limits. Certainly one of the factors in estimating

net income is property expenses and any discussion is pertinent at this time which attempts to distinguish between property expenses and expenses of ownership.

It is generally accepted that the appraised VALUE of real estate would not vary because of the type of ownership or whether or not the owner places a mortgage on the property. Any theory to the contrary is untenable. It naturally follows that the appraiser should assume that the property to be appraised is in individual ownership and is free and clear of all encumbrances, regardless of the type of ownership or the amount of mortgage loans. With these assumptions, those costs of special ownership and of financing and servicing mortgage loans are excluded from property expenses and are considered expenses of ownership. Ownerships by corporations, by receivers, trustees, bondholder committees, etc., are special ownerships and the expenses peculiar to such ownerships should not be included in property expenses. The salaries of officers, directors' compensation, expenses of corporation records, special corporation taxes and fees such as franchise tax, registration fees, capital stock tax, etc., stockholders' records and dividend payments and all other salaries and all other expenses necessary to corporate ownership, are ownership and not property expenses. In like manner, the fees of receivers, trustees and attorneys in connection with such special ownership, including court costs and the expense involved in litigation over titles, foreclosures and other matters of an ownership nature, are not considered property expenses.

The assumption that the property is clear and free of all encumbrances follows accepted practice, and all expenses and costs incidental to financing the interest on and the amortization of mortgage loans and all other expenses necessary in servicing the loan are ownership expenses. It has been the general practice of appraisers to determine the net income of a property before interest, amortization and depreciation. Like interest and amortization costs of mortgage loans, depreciation is not a property expense but represents the annual return of capital to the owner which is included in the net income the owner receives from the property. All sound appraisal procedure is based upon the return of the present VALUE of the property (generally the improvements) in the estimated useful life of the property. It is the function of ownership to set aside that part of the net income received from the property as a return of capital. The cost to the owner of handling the depreciation reserve, its reinvestment, etc., is one of the factors in fixing the capitalization rates of real estate income. However, in specifying a definite remaining useful life during which the appraised net income will be received, depreciation is provided in the determination of the VALUE of the property. While the average owner seldom forgets to deduct depreciation in figuring income taxes, it is unfortunate that he usually fails to accumulate a depreciation reserve which represents the return of capital.

PROPERTY EXPENSES Property expenses should include all costs and expenses (1) to manage, operate and service the property; (2) to maintain, repair and replace those parts of the property which have deteriorated from time and use; (3) to pay all fees and taxes which are assessed against the property and payrolls for the support of government; and (4) to pay the premiums for insuring against losses of the physical property by fire, storm, public commotion, bombing, etc.

In Bulletin #13 special emphasis was placed on the fact that management was essential in the operation of investment properties and that a charge for management must be included in property expenses even though the owner donates his time in the management of the property and makes no charge. Management charges should include the costs of securing tenants and, when necessary, of evicting tenants, leasing commissions, necessary management payroll, bookkeeping and accounting costs, telephone, local manager and rental value of manager's quarters when provided, management agencies' fees and all other costs and expenses incurred in the actual management of the property. No costs of special ownership previously referred to are considered management costs.

While of minor importance, association dues and convention costs, donations, etc., are not considered property expenses. The usual and customary fee charged for similar types of property in the city in which the property is located should be used by the appraiser in estimating management when actual management costs appear out of line. The average management cost of more than 450 office buildings in the United States is about 13.6¢ per square foot of rentable area or about 9.6% of gross office rent. For apartment properties the agency management charge is about 5% of gross rent plus the expense cost of building manager and manager's quarters, etc.

We have covered in previous bulletins the interval nature of many maintenance and repair items and the necessity of estimating the average maintenance and repair costs to the general building and grounds, tenants' space and mechanical equipment. Practically all maintenance and repair expenses which are considered property expenses are those costs and expenses necessary to remove deterioration and restore suitable habitation. Generally those costs to remove obsolescence are capital expenditures and not a part of property expenses. Costs of additions, of general remodeling, of installing new equipment, etc., with the expectation of increasing rents or lowering expenses through modernization are capital expenditures and are not deductions in finding net income. The cost of original division of office space is a capital expenditure. Subsequent alterations for tenants' needs are generally considered property expenses under conditions existing for the past twelve years, although in the twenties the tenant paid the cost of alterations made to meet his own needs; however, in periods of large surplus office space, the owner must stand the expense of alterations which the tenant should justifiably pay.

Property taxes, street cleaning taxes when separately made and social security and unemployment taxes on property are the primary fixed expenses of a property. Benefit taxes assessed against properties for public improvements made are not a part of property expense but are considered capital expenditures.

There is greater confusion concerning insurance premiums as a part of property expenses than any other item. Insurance is for the purpose of protecting the owner from losses which may occur in the future as the result of acts of God, robbery, or from liability for damages to employees and the public.

Primarily it is for the protection of the capital of the owner and should be classed as expense of ownership and not the property. Cost of insurance is not a deductible expense in figuring taxable income and, logically, insurance premiums should not be included in property expenses for appraisal purposes. It has been our practice to include insurance costs for fire, tornado and pub-

lic commotion because it is a general custom for owners to carry this type of insurance on practically all types of properties and capitalization rates are adjusted to the inclusion of this type of insurance cost in property expenses. However, we do not include boiler insurance, payroll insurance, employee and public liability insurance, etc., even when such insurance is in force on the property appraised. The cost of such types of insurance is considered expense of ownership. If it should be found that for certain types of properties it is customary in certain cities for owners to carry such types of insurance, it is our opinion that the cost should be included in property expense even if such insurance were not carried on the property appraised.

It is important for purposes of reaching an opinion of VALUE for any type of real property for the appraiser to follow not only a uniform classification of property expenses but to use a uniform method in estimating each item of property expense. The same items of expense should be used for all types of properties. The intelligent distinction between purely property expenses and the expenses and costs of ownership is necessary in appraising by the income approach. In our opinion there will never be any mechanical process for appraising real estate values because in the last analysis, the opinion of the appraiser will govern; however, definitives, methods, limits and checks provided by modern appraisal practice can act as a guide in forming harmonious opinions among appraisers who follow sound appraisal procedure.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

15

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1963, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

APARTMENT CAPITALIZATION RATES

NET INCOME AND REMAINING USEFUL LIFE

It has been stressed in previous bulletins that extreme care must be exercised by the appraiser in finding the expected net income for a definite number of years in the application of the income approach to VALUE. The transition of an investment property to an annuity and a period of time represents the dollar measure of its present and future usefulness. It is important to realize just what this important step in the income approach embraces before the capitalization process is completed.

In our opinion the appraiser in finding expected net income and remaining useful life should include and weigh every factor of a physical, functional, social and economic nature which affects the present and the probable future usefulness of the property to be appraised.

There is not a general agreement with this opinion among persons directly or indirectly concerned in real estate appraising. We are informed that the appraisal policy of a large insurance company in the East uses a higher capitalization rate on older properties than it does on newer properties of the same type. Another adjusts capitalization rates for adverse environment and still another appraiser states that such items as modern kitchens, modern plumbing, air conditioning and insulation are factors in establishing capitalization rates. If these contentions are correct, each individual property would require its own particular rate and there would be little chance in stabilizing capitalization rates for properties of like type located in the same investment market. With this we do not agree and we believe that all such items as age, environment, equipment, etc., are factors affecting use and are measured in rents, expenses, occupancy or remaining useful life estimated by the appraiser.

ELEMENTS OF CAPITALIZATION RATES

The elements governing capitalization rates do not concern the use of the property but refer to the investment which is represented by the expected net income and the period in which this income could be reasonably expected. In Bulletin #5 these elements are briefly outlined as (1) pure interest; (2) element of risk; (3) extent of liquidity; (4) supervision of investment.

The element of risk is present in varying degrees in all types of investments except those investments whose return is solely pure interest. The risk connected with all types of investments concerns all influences which may adversely affect the income stream or jeopardize the investment. While property expenses include the cost of insurance for protection against losses to the

physical property by the elements or from damages resulting from the operation or ownership of the property, those risks not customarily covered by insurance or inadequate coverage must be carried by the owner and will be reflected in the capitalization rate. These uncovered risks are generally slight with most types of properties, although foundation weakness or unexpected sub-soil faults are a real risk in some localities.

The unforeseen shifts in business activities or unexpected social and racial trends are risks which must be carried by the owner. Likewise, real estate on account of its immovable fixed supply and its slowness to react to changing demand is subject to economic changes of intense severity. All such risks of possible adverse changes of an economic, social and racial nature peculiar to real properties must be carried by the owner and are reflected in the capitalization rate.

Perhaps real estate taxes are the most important problem affecting real estate investments. The very physical nature of real estate lends itself as the medium for carrying almost the entire cost of State, county and municipal governments. The necessity for a stable tax income requires the adoption of fictitious values for assessments and distributing the tax load on real estate. Such assessed values as "full" value or "true" value bear little relation to the economic value and in a great many instances real estate taxes become a capital tax or a penalty upon ownership. It is the theory that the owner can pass the taxes to the tenant through rent; however, in reality the owner cannot include all the taxes as part of the rent, especially in periods of surplus when depressed rents and vacancies without corresponding reduction of taxes require a larger and larger percentage of net income for taxes. Some properties have been taxed for nearly a hundred percent of net income before taxes and destroyed the investment in time of distress.

Many properties have been assessed for benefits for municipal improvements which did not enhance their VALUE. There is now a potential threat against properties in many cities which may have to compete unfairly with subsidized properties built for city redevelopment. Today ceiling prices have been placed upon rents of residential property at an unfair level in comparison with other living costs merely because rents are comparatively easy to control and owners have too few votes. It is noticed that such factors as age of the property, quality of environment, the design or layout of the property, amenities, etc., are not considered as risks to be included in capitalization rates but in our opinion are provided for in expected net income and remaining useful life.

Real estate must be sold in its entirety and part of the investment cannot be liquidated. The market is local for almost all types of properties. Each property being individual, each has its own desirability. Sales must be negotiated between buyer and seller and the cost of sale is high in comparison with other types of investment ranging from five to fifty per of the equity, depending upon the financing. The extent to which properties can be financed in the mortgage market is a vital factor in creating a market and establishing liquidity. Generally, luxury residences and apartments and specialties have low liquidity; the small single-family dwelling has the best liquidity. Large estates have extremely low liquidity.

When every cost of property management is included in property expenses, only the supervision of the investment is an element of capitalization rates.

The reinvestment of the annual return of capital which is included as part of property net income, checking accounts and such inspection to determine the condition of the property and the efficiency of management, etc., require supervision which is reflected in capitalization rates with all types of real properties.

The appraiser does not fix the capitalization rate, neither can he estimate the rate by combining his estimates of the elements composing the rate. Investors and owners establish capitalization rates in the market and the appraiser must look to the actual sales of comparable properties and estimate the rate of capitalization to be applied from such sales.

As with any comparison method, the properties used for comparison must be selected with extreme care and the factors concerning each property and the conditions surrounding the sale of each must be studied and analyzed before it is used for purposes of comparison. A few of the most important points to be considered are as follows: (1) Market conditions must exist indicated by a sufficient number of sales of the type of property to be appraised. (2) The sales should be voluntarily made by both buyer and seller in the open market. (3) The sales should be made on an equivalent of cash basis. If financed with a first mortgage loan, such loan should be at such a loan-value ratio and rate of interest as to be marketable at full value. (4) The property should be in good condition for its age and the income and expense should reflect market conditions and competent management.

It is found that by adopting the procedure and using the rates indicated in the following capitalization process, values would be obtained very closely approximating the market transactions in the St. Louis territory. The rates given are for unfurnished apartments and are applicable regardless of the age of the property and the remaining useful life. Net income is capitalized before depreciation and the improvements are made residual to the land.

APARTMENT RATES

The value of the land is determined from actual sales of similar land and a fixed return of 6% to 7% (we are now using 6%) is deducted from the net income from the property before depreciation. The residual net income applicable to the improvements is considered to include the return of the VALUE of the improvements in the estimated remaining useful life and to pay a rate of return of 8%. The present worth of a cumulative annuity table (Inwood) is applicable for this process.

In the October 1942 issue of the Appraisal Journal, Robert L. Free, M.A.I., states that this procedure is followed and by using rates of 6% on the land and 8% on the improvements he closely approximates actual sales of apartment properties in the Cleveland territory. In this same issue, John C. Tredwell, M.A.I., gives certain data applying to actual sales of a number of typical six-story non-fireproof elevator apartment buildings in New York City, stating: "That buyers who pay all cash, or sufficient cash so that the balance is readily financed in the First Mortgage Market, will pay about 5.7 times the gross rent (gross rent capitalized at $17\frac{1}{2}$ per cent) and will accept an overall capitalization rate before depreciation of 8.2 per cent; and that this is equivalent to a rate of 13.75 per cent before depreciation on their equity."

Applying the foregoing procedure to the data given by Mr. Tredwell and making the assumption that the average apartment had a gross income of \$50,000

(any sum would give the same result) and a ratio of value of improvements to land of 3.1, the following results are obtained:

Land .25 x 285,000 -----	\$ 71,250
Improvements .75 x 285,000-----	213,750
Market price 50,000 x 5.7-----	285,000
Gross rent assumed -----	50,000
Vacancy allowance & expenses, estimated--	26,630
Net income 8.2% of 285,000 -----	23,370
Net inc. applicable to land .06 x 71,250	4,275
Net income applicable to improvements	19,095
Value of land 4275 ÷ .06 = -----	\$ 71,250
Value of improvements 19,095 x (11.19)	213,750
Total Value	\$285,000

From the Inwood table the factor 11.19 represents a rate of 8% and an average remaining useful life of approximately 30 years (11.258). Therefore it would appear that this capitalization procedure and the rates of 6% on the land and 8% on the improvements closely approximate the average market price of apartments in the New York territory. Our experience in other cities besides the three mentioned would indicate a more general application of the rates herein designated for unfurnished apartments.

We appreciate that there are other capitalization procedures used by qualified appraisers which are based upon the investor's measure of VALUE and which would give different rates from the rates suggested herein. We do believe that the approach suggested allows the appraiser to estimate VALUE for unfurnished apartments without variation in the rate because of the location, environment, age and other influences affecting the usefulness of the property.

In the following table an attempt has been made to weigh each of the four elements composing foregoing capitalization rates on the land and improvements of 6% and 8% respectively of unfurnished apartments. It is realized that this breakdown has no factual basis upon which to make an accurate estimate. Pure interest has been estimated at 2% although it may be slightly greater or less than this level according to the selection made of government obligations. The weighting given the other three elements represents merely our judgement. For this reason the error may be great and only approximations have been attempted.

APARTMENT CAPITALIZATION RATES

	Land	Improvements
Pure Interest	2.0	2.0
Risk	2.0	4.0
Liquidity	1.5	1.5
Investment Supervision	0.5	0.5
Total Rate	6.0	8.0

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

16

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

MORTGAGE INTEREST RATES

It is quite evident that mortgage financing is a strong factor in creating effective demand and in contributing to the sale of real properties. Although we have no factual data as to the number of sales actually made without the aid of financing in relation to total sales, it is generally recognized that without the aid of mortgage loans, demand would be less effective, sales would decline and real estate markets would be slim with further lowering of the liquidity and narrowing the ownership of real properties. This is evident from the very nature of demand which, to be effective, requires the presence of two elements: (1) desire, and (2) ability to gratify desire. Sales effort stimulates desire and mortgage financing contributes to the ability to gratify.

From the 1940 census it is noted that of the 11,413,259 nonfarm, owner-occupied structures containing one to four family units in the United States on that date, about 55% were free of mortgage. About 85% of these structures were of the single-family type and evidently the properties in this group have varying ages. The fact that the majority of these properties were then unencumbered does not necessarily indicate that they were built or purchased without the aid of mortgage financing, but more likely that the original loans were paid off.

A mortgage is a conveyance of property, coupled with specified conditions, which can be nullified by their performance by the mortgagor. The conditions of the mortgage or its pattern include such items as the amount and period of the loan, the amounts and times of the amortization of the loan and the rate and time of payment of interest. The mortgage pattern for each type of property is established at such times, terms and conditions that the property can be readily financed in the mortgage market, and that sales so financed are the equivalent of all cash sales.

Mortgage interest rates are influenced by the same four elements which influence the rate of returns on all investments, including capitalization rates, which were briefly discussed in Bulletin 15. Naturally, the VALUE of the property for which a loan is proposed forms the underlying measure or base of the mortgage pattern. The determination of VALUE in a sound and competent manner is of primary importance to the mortgagee. An opinion of VALUE by an appraiser without his accompanying analysis of how he formed and checked his conclusion does not give the mortgagee a complete enough picture of the present and future usefulness of the property to formulate a proper mortgage pattern. Especially with investment properties where the present and future usefulness of the property is directly measurable, in net income and remaining useful life, such information and the capitalization process are of the utmost

importance to the mortgagee.

The mortgage pattern adopted in each instance should be on the basis that the property itself represents the sole security for the loan. Such added security indicated by the responsibility of the mortgagor, deficiency judgment, etc., should not be a factor in forming the mortgage pattern. Naturally, with those properties whose use is not reflected directly in money income, such as the single-family residence, the credit rating of the mortgagor is important in determining the ability of the mortgagor to meet the mortgage payments, just as the net income of investment properties is the determining factor. Good credit rating of the mortgagor should not be a factor in increasing the amount of loan, as the mortgagee is not acting as a commercial banker but must depend upon the property alone for the mortgage security.

The risk element is the most important influence in mortgage interest rates. Three factors are determinants of risk: (1) the loan-VALUE ratio; (2) the period of the loan; and (3) the rate of amortization of loan. The loan-VALUE ratio represents that portion of VALUE which the mortgagee agrees to loan to the mortgagor under certain times, terms and conditions specified in the mortgage. The larger the loan-VALUE ratio the greater the risk the mortgagee assumes, all other factors remaining the same. This is self-evident because as the loan-VALUE increases the interest rate should increase and would reach the over-all capitalization rate when the loan-VALUE ratio reaches 100%. This is illustrated in Bulletin 15 on capitalization rates, which indicates that with unfurnished elevator apartments in New York City, the investor purchases on the basis of a return of 13.75% before depreciation on the forty per cent equity, while the interest on the sixty per cent mortgage loan is $4\frac{1}{2}\%$. This interest rate would increase when the per cent of loan increases and the mortgagee assumes more and more of the risk in the equity until the percentage reaches 100% or the equivalent of the purchase of the property when a composite rate of 7.5% is obtained.

The second and third elements of risk concern the period of the loan and the rate at which the principal shall be repaid. The shorter, unamortized loans of former days are now being supplemented with longer loans regularly amortized. Amortization is sound in that it follows the natural and expected decline in the VALUE of the property from deterioration and obsolescence. The failure to require the loan to be amortized upon the assumption that the appreciation of land value would more than offset the depreciation in the value of the improvements, even when the assumption may appear warranted by past experience, is not in accord with conservative and sound lending policy. Amortization of the loan lowers the risk and is good insurance of the capital invested. This is well recognized by the lending institutions who, on account of their fiduciary status in lending other people's money, take every precaution to safeguard the capital entrusted to them.

It is believed that the period of the loan should be about 50% of the remaining useful life of the property as estimated by the appraiser and substantiated by the mortgagee. All of the loan should be amortized in the period of the loan. It may be that on account of the cyclic position at the time of the loan or of some circumstances surrounding leases, etc., the mortgagee may require different rates of amortization during the loan period.

Today when there is a large flood of money seeking investments, considerable pressure is placed on the appraiser, especially by some loan correspond-

ents, to make optimistic appraisal reports. It has been called to our attention that some appraisers are asked to make contingent appraisals by sacrificing a large part of the appraisal fee in case the loan transaction is not completed. This pressure is generally present when there is keen competition for loans. It is flavored with the policy of the heyday twenties when the value of the property was established to suit the amount of loan desired. It is unnecessary for the appraiser to know the amount of loan applied for in making his appraisal and the loan-VALUE ratio is purely the business of the mortgagee and not the concern of the appraiser.

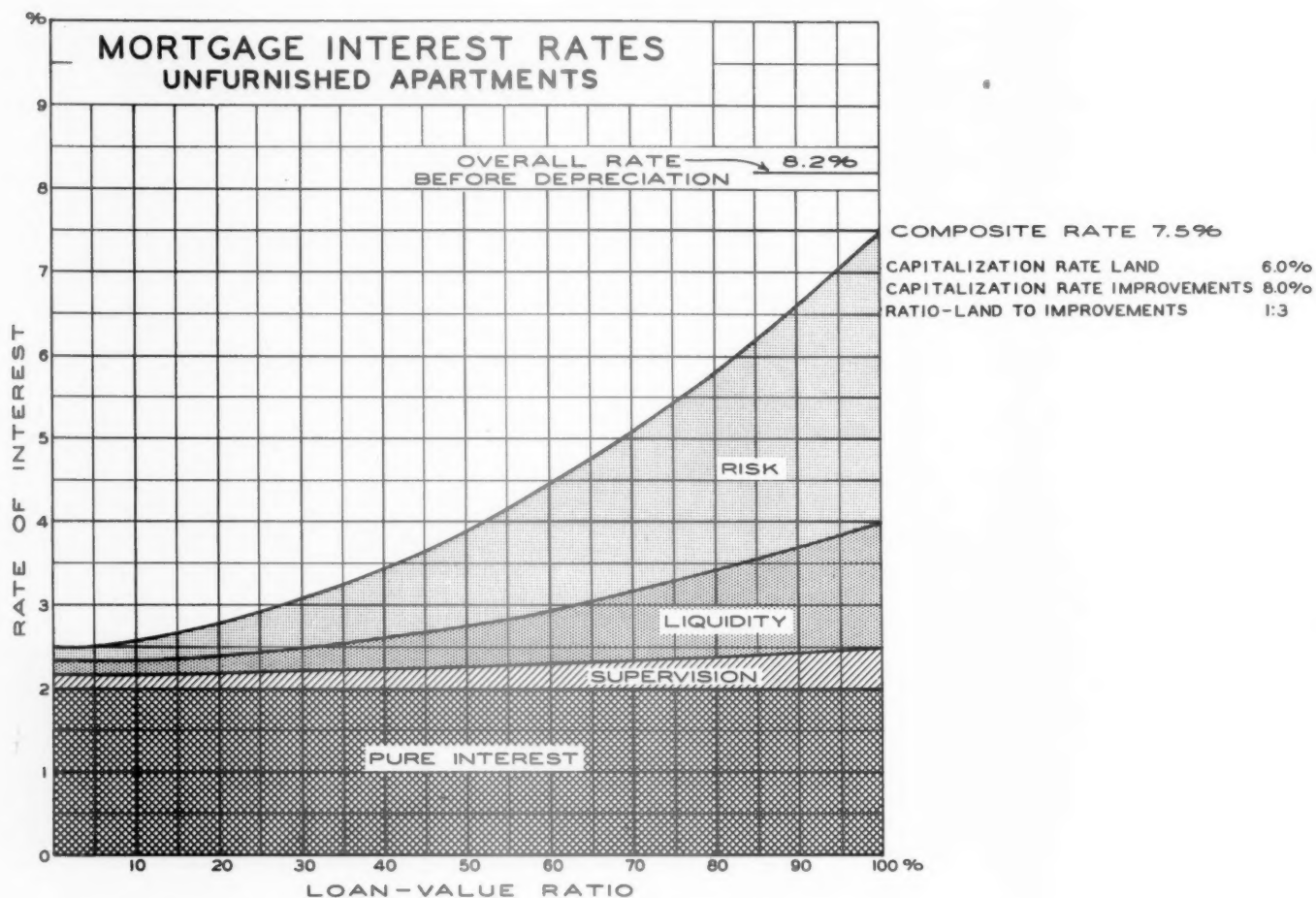
Government insured loans of high loan-VALUE ratios and low interest rates, amortized over a long period of years, were adopted to stimulate new construction at a time when the construction industry was at a low level. They accomplished their purpose in stimulating new construction by increasing demand at a time when additions to the supply were not needed, thereby creating distress in existing residential properties. The guarantee in FHA loans removes much of the risk and permits low interest rates on certain types of residential properties. The real security for FHA loans is not the real estate but the government guarantee; they are bought and sold by institutions not on account of the property and its location but upon the basis that the only risk involved would be to change the mortgage into FHA debentures. FHA mortgages can be compared to a note made by a maker with doubtful security but with a financially strong endorser. In our opinion, the rate of interest on FHA loans is too high in comparison with the amount of risk involved.

While the supposed emergency for which FHA was created is past, it is quite probable that the policy of underwriting high risk mortgages will be continued in the post-war period to provide social gains to special groups of property owners. However, while most FHA loans were on new small dwellings, built in the environs of most metropolitan cities and were a strong decentralizing influence because they competed unfairly with existing properties in the inner city, it may develop that it will be necessary to curtail FHA loans on such properties in the post-war period because of their unfair competition with the proposed redevelopment of the inner city which the government is now advocating.

Purchase money mortgages generally provide the means to consummate a trial sale for the convenience of the owner who acts as mortgagee and for speculation on the part of the purchaser. Having exceptionally high loan-VALUE ratios varying from 90% to 120%, with relatively low interest rates and low amortization payments, such mortgages are not the equivalent of cash, are individually negotiated and are purely speculative in character.

The small chart on page 84 gives the interest rates of mortgages on unfurnished apartments for different loan-VALUE ratios. A sixty per cent loan-VALUE ratio with interest at $4\frac{1}{2}\%$ and with the full loan to be amortized in the period of the loan of 15 years is the loan pattern at which unfurnished apartments can be readily financed in most metropolitan cities. The 100% rate represents the composite rate of 6% on the land and 8% on the improvements, with a land-improvement value ratio of 1 to 3. A ten per cent loan has been assumed at 2.6%. The curve of gross rate has been drawn through these three points, which in our opinion represents a reasonably close approximation.

Without sufficient data, we have attempted to weigh the four elements which compose mortgage interest rates. Perhaps it would be more prudent to



indicate merely pure interest and represent the remainder as the combined influence of risk, extent of liquidity and investment supervision. It should be realized the breakdown given is merely an opinion without factual data to support it.

For the duration it is believed that the mortgage interest rates should continue at the present relatively low level. Interest rates on direct and guaranteed obligations of the government have reduced nearly a quarter of a per cent from a year ago to 1.964%. Demand for real estate mortgage loans has been declining during the past year while the present large volume of money seeking mortgage investments continues. However, the probable large demand for risk capital and the probability of some inflation in the post-war period should tend to stiffen mortgage interest rates.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

17

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

REAL ESTATE ANALYSTS, INC.

Real Estate Economists, Appraisers and Counselors

Copyright 1943, by REAL ESTATE ANALYSTS, Inc. — Saint Louis

Roy Wenzlick
Editor

THE EFFICACY OF APPRAISAL PROCEDURE

INCONSISTENT OPINIONS

There is much criticism of appraisal practice by many persons engaged or interested in real estate. We have received several inquiries whether modern theoretical techniques have been able to produce more consistent results than pre-depression practices. There are many who doubt the efficacy of appraisal theory in general and claim one man's guess is as good as another's. Certainly, appraisers have fostered the implications that appraising is a sort of a racket and any opinion of value can be secured for the asking. These implications arise from the wide variation in the appraised values of a particular property which are publicly revealed when appraising for legal purposes. Our courts express wonder and concern, juries are baffled and confused with the excessive range in the testimony of so-called experts and attorneys in litigations involving real estate values experience little difficulty in securing qualified appraisers to support with their testimony the widely divergent claims of both sides of any case.

Unfortunately, these wide ranges in opinions are not confined to properties in litigation but are quite common in appraising for non-legal purposes. We have seen the high value almost 70% above the low value appraised by apparently qualified appraisers when the sole purpose of each was to reach a sound conclusion. Realizing the high purpose and sincerity of the vast majority in the appraisal profession and appreciating the gains already made in appraisal knowledge and procedure, it is perhaps not untimely to attempt to point out some of the weaknesses in modern appraisal practice, which in our opinion are basic causes and apparently contribute to unreasonable variations in opinions.

Appraising is a technical art and can never be an exact science; it involves the mental measure of the economic significance of real properties in our existing economy caused by the actions and transactions of man. The only evidence of this economic significance is prices revealed in the actual markets of production, of use and of exchange of real properties. All theories, procedures and processes must be merely measures and guides in helping the appraiser to reach sound conclusions of this economic significance.

Naturally the soundness and reasonableness of any APPRAISER'S QUALIFICATIONS mental measure depends upon the qualifications of the appraiser in temperament and aptitude as well as in knowledge, intelligence, training, judgment and experience. Perhaps the most common cause of divergent opinions are those appraisers who are unsuited in aptitude and temperament. Usually such persons are unable to apply a neutral and judicial attitude or to assume a disinterested and detached viewpoint. They find it difficult to analyze from cause to effect and are easily

swayed in their opinions by the result desired and become the partisan or advocate. Generally they are strongly influenced in their opinions of value by the claims of the side for which they testify, by the amount of loan desired or for some other result. The advocate type of appraiser is much more detrimental to the reputation of the appraisal profession than the occasional unmoral type who looks lightly upon giving an opinion when a fee is involved or a friend is to be accommodated or even the chronic optimist or pessimist who is consistently high or low.

Perhaps no other profession requires such a broad background of knowledge as that of appraising. No doubt the underlying principles of such subjects as engineering, architecture, statistics, accounting, city planning, land development, etc., add greatly to the qualifications of the appraiser. He must have a thorough understanding of the principles of economics and of those influences which create or destroy values. It is essential that the appraiser have training and experience in construction, management, brokerage and financing of real estate, and he must be constantly in touch with the construction, rental and exchange markets. Regardless of the knowledge possessed, the appraiser must have the experience to apply it to appraisal problems with intelligence, judgment and common sense. The field of appraising is so large that the appraiser often assumes appraisal problems which his experience would not qualify him to undertake. This is a real cause of differences in opinions among appraisers.

UNVERIFIED OPINIONS While the basic cause of unreasonable divergence of opinions can be placed on lack of qualifications of appraisers, some of the blame must be placed upon the measures and guides used by the appraiser in reaching his conclusions. It is not a help to clear thinking when terms defined in the Terminology Manual run contrary to customary usage and are not subject to a single interpretation. It leads to confusion and misunderstanding to define Value as an "ought to be" price and to state that Market Value is a warranted and justified price in some markets where buyers and sellers act with intelligence, knowledge and willingness but that when a sale is involved or inferred, Value and Market Value are synonymous. Market Value becomes an "ought to be" market price and does not mean the price which would result from a voluntary sale in an actual market of exchange if the property were exposed for sale.

Intelligence, knowledge and willingness are relative qualities and are subject to many interpretations by appraisers with varying degrees of intelligence, knowledge and willingness. Many theory-minded appraisers who assume they possess these qualities to a high degree follow their valuation process in great detail and arrive at a result by entirely ignoring actual market conditions. The capitalization process which is considered the principal approach to Value of income properties, illustrates the many steps in which the appraiser must estimate many items and for which he must exercise his opinion or estimate without any factual data to guide him.

Gross rental income, which is the price of full use of the property to be appraised, can be capitalized direct but the rate used must include the following estimates: (1) an allowance for vacancy and other income loss during the remaining future life; (2) the property expenses, including reserves for non-recurring items; (3) the probable future patterns of net income; (4) the period in which the investment should be returned; (5) the rate of return on the investment; and (6) the completion of the capitalization process. If net

income is capitalized direct, the capitalization rate used must include estimates of the last four steps. Modern appraisal theory includes estimates for all six of these steps. While some items in step 2 are actual costs such as taxes and insurance, we have witnessed differences in estimates of property expenses as much as 20%. The goal of the capitalization process is a capitalized sum which represents the Value of the property as an investment. It is our belief that one of the principal causes of divergent results is the fact that this goal is often reached by capitalization theory without bench marks or controls determined from the realism of actual markets.

If the appraiser neglects to use Maximum Value to sight on in one direction and Market Value determined from open market sales in the other direction the appraiser will never know where he is and is like the navigator who sails blind without any checks on his various courses and without instruments to find out where he has arrived.

We do not believe that Maximum Value is merely the highest level above which Value cannot go; it is also a bench mark from which depreciation is measured, and if the Value determined from capitalization shows a difference from Maximum Value which is unreasonable in relation to the amount of depreciation estimated from observation and other calculations, some doubt is raised as to the soundness of Value so determined. The other bench mark is Market Value estimated from actual open market sales of comparable properties. Open market sales are realistic and positive evidence of Value. When Value is determined by capitalizing net income, which is the return from use, such capitalized sum represents the Value from use or the Value of the property as an investment. It is indeed foolish not to measure and compare such capitalized sum with the attitude of investors in actual markets. In our opinion it is a fallacy to state that Value as an investment is based upon the premises of intelligence, knowledge and willingness of buyers and sellers and that the appraiser has the ability or knowledge to disregard investor's attitude because in the appraiser's opinion investors in the market lack these qualities.

The investor's attitude in markets with a balanced demand-to-supply relationship when costs, rents and prices are in proper relationship can be the only basis on which appraisal theory and capitalization rates can be determined by the appraiser. In such markets, Value from capitalized income and the estimated Market Value from market sales of comparable properties are equal in amount. The danger of all theoretical appraisal techniques is that the appraiser assumes for himself some super intelligence and knowledge and differs with the investor's attitude under such market conditions.

Any difference which the appraiser determines between his estimates of Value and actual Market Value cannot be lightly ignored because of supposed vagaries of the market or lack of intelligence, knowledge, etc., but such variations must be verified and substantiated by studies of existing market conditions. It is well known that in different cycle periods the relationship of demand to supply becomes unbalanced and that costs, rents and prices become out of balance. While unbalanced markets create influences which tend to bring them back into balance, real estate markets respond much slower than markets for all other types of goods. In periods of shortage, prices become out of balance with costs and rents, markets become extremely active and prices are generally above values. New properties sell at prices above their Maximum Values. Such market conditions create excesses which are followed by periods of liquidation when prices drop below values. Markets become listless

and new properties, if built, would sell below their Maximum Values. The extent of the excesses determines the extent of the following liquidations. It is only on very rare occasions that land booms similar to the tragedy in Florida occur. In such cases when hysteria and chaos rule, there is no measurable relationship between prices and values.

When the attitude of purchasers in the market is for purposes other than the investment involved, such as for speculation or for income tax savings, etc., prices may become out of balance with costs and rents for the moment. It is a fallacy to assume that the speculator violates the premise of intelligence, knowledge and willingness because often the speculator takes less risk than the conservative investor and in addition to intelligence and knowledge, often possesses business prudence and judgment.

It is the appraiser's function to know when unbalanced market conditions exist, to know the cause of the unbalance and to estimate the variation of Market Value above or below the Value determined from reproduction cost or from capitalized income. The appraiser substantiates his estimates of Value with the other two key Values (Maximum Value and Market Value, see Bulletin 1) which are determined from actual markets of construction and exchange.

Fundamentally, appraising comprises the expression of opinions formed from observation and estimates of many tangible and intangible influences and it is almost certain that there will be decided differences in opinions. The extent of variations depends primarily upon the qualifications of the appraiser and secondarily on the soundness of his theories of Value and the judgment used in their applications to specific properties. There are many engaged in the practice of appraising who lack the qualifications to reach sound and consistent conclusions. Even among those appraisers who possess the qualifications of aptitude, knowledge, judgment, training and experience, there will be found considerable spread in opinions. It is believed that among competent and qualified appraisers a spread not exceeding 15% between the high and the low values appraised would not be considered unreasonable; however, from our observations and experience this range would appear optimistic.

A. B. Kissack
A. B. Kissack, M.A.I.



APPRAISAL BULLETIN

18

PUBLISHED IN THE INTERESTS OF REAL ESTATE ANALYST SUBSCRIBERS BY

ROY WENZLICK & CO.

Real Estate Economists, Appraisers and Counselors

Copyright 1963, by ROY WENZLICK & CO. — Saint Louis

Roy Wenzlick
Editor

ACTUAL AND THEORETICAL FUTURE PATTERNS

FUTURE patterns of rents and net income of investment properties and the rates of future depreciation of all types of improved properties present constant problems to the appraiser. The probable future behavior of real estate is of vital importance not only to the appraiser but to all who are interested in real estate. Owners and prospective investors are basically interested in the future use of real properties. The future behavior of values is all-important to the mortgagee because the risk element involved depends greatly on this future behavior.

Appraisers generally are inclined to base future patterns of net income solely on the basis of the natural decline in value from depreciation. Those factors of a physical, functional and economic nature which affect the property and its environment and cause a permanent loss in value control our thinking in establishing future patterns of depreciation. Although we have no factual data concerning the useful lives of properties or the rates at which future depreciation will occur, it is evident that the decline in usefulness and values from depreciation is certain and that the end of usefulness will come as sure as death and taxes.

The reasons for our inability to gather reliable data of future depreciation of different types of properties are that costs and prices and the values estimated therefrom are influenced by factors other than depreciation. A study of past experience reveals that costs, rents and prices are influenced to a greater extent by shortages and surpluses and by changes in the value of the monetary medium than by the destructive influences of depreciation. This is illustrated by the chart on page 91 in which we have estimated the maximum value of a standard frame house, the cost of which in St. Louis is given by years from 1913 to date in Appraisal Bulletin #1.

We have assumed that this residence is built on a lot with a constant value of \$1,500 (50 feet @ \$30.00) during this same period. The maximum value of this house determined by adding this value of the land to the cost of the house for each year is shown by the full line on the chart. We have found the value of the property for each year by deducting from the maximum value for that year the depreciation accrued at the conventional rate of 2% per year. On this basis it is possible to estimate the "value" of the standard house for each year after it was built. If it were assumed that this identical house had been built in 1915, 1920, 1924 and 1932, the lines A, B, C and D respectively would indicate its "value" for each year after those dates.

Lines A1, B1, C1 and D1 represent the pattern used by the appraiser (2%

annual straight line depreciation) who assumes depreciation to be the sole influence affecting value and ignores those other influences affecting prices and values.

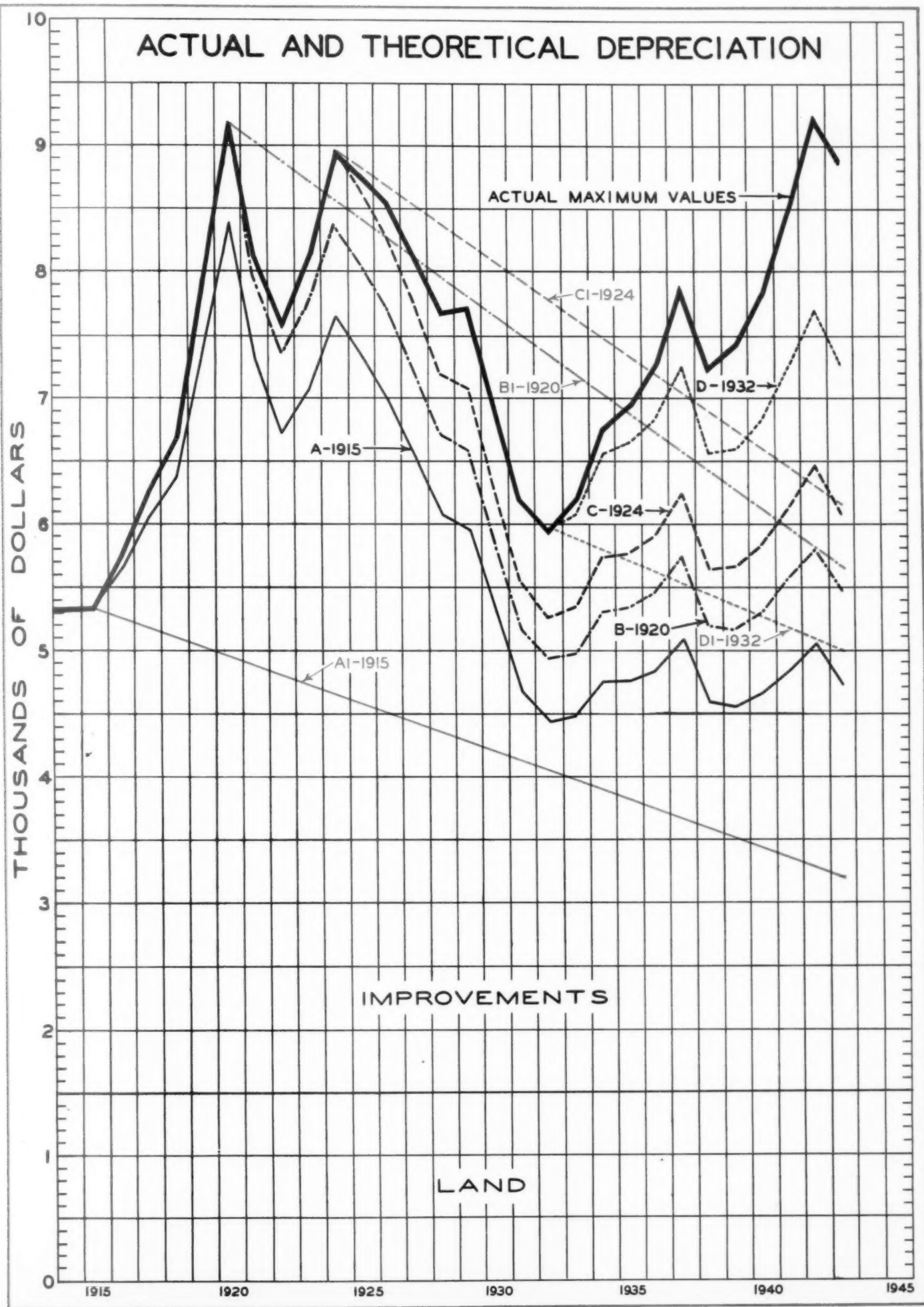
It is of interest to note the wide variation between the actual values of the house built in 1915 with the values based upon the conventional straight line depreciation of 2% as shown by the lines A and A1. In every year of the 28 years following 1915, the actual value was above the straight line pattern, rising 56% above the 1915 value in 1920. This house which had a value of \$5,340 in 1915 had a value 27 years later of \$5,040 and suffered only a slight loss in value. On the other hand, the house built in 1920 had an actual value (B) which was below the values based upon the conventional 2% straight line depreciation (B1) in every year from 1920 to 1942. In fact, the standard house built in 1920 at a price of \$9,180 had a value of \$4,905 in 1932 and suffered a loss in value of 55% in this 12-year period.

It will be noted that the house built in 1924 (C and C1) shows the same extreme depreciation experienced as the house built in 1920 and also that the house built in 1933 (D and D1) shows similar favorable conditions to the house built in 1915. It is evident that these extreme fluctuations in values result from periods of shortage and surplus and in large part from inflationary and deflationary influences caused by changes in the value of the dollar. If the value of the dollar declines, its purchasing power diminishes and prices rise, or when it rises in value, its purchasing power increases and prices fall.

The value of the dollar or its purchasing power is measured by an index of wholesale commodity prices including over 800 items, weighted as they occur in our economy. This index is prepared and published currently by the Bureau of Labor Statistics. The value of the dollar rises and falls according to (1) the amount of "usable money," which includes currency in circulation and bank deposits; (2) the velocity of its use or the rate of turnover; and (3) the relation of money to work which has to be done. During the middle twenties the value of the dollar was about 70% of the 1913 level; by 1932 its value had risen to 107.5% of the 1913 level and in 1942 and 1943 it had again dropped to 71% and 68% respectively of the 1913 level.

Today the "usable money" per capita is about 25% above the highest amount available during the twenties in 1928; although the present velocity or rate of turnover is much less than in the twenties, there exist today potentialities for further and perhaps serious inflation unless government controls can be made more effective.

We have found that the maximum values of investment properties are quite similar in their variations to the maximum values of the standard frame house shown on the chart. Likewise, rents which are the price of use reflect shortages and surpluses and changes in the value of the dollar. In our opinion the period in the cycle plays an all-important part in the future pattern for the return of the investment in any appraisal process. The standard house built in 1924 declined 40% in value by 1932, a loss in total value of 5% per year, or depreciation of the improvements of almost 6% per year. A like decline in the value of an apartment property appraised from the high rents existing in 1924 took place during the period from 1924 to 1932. The pattern of future depreciation or return of the investment should be entirely different for properties appraised in such years as 1920 or 1924 than in years such as 1915 and 1933. In our opinion the appraiser cannot adopt patterns of future rents



or some theoretical basis of return of the investment which ignores the time at which the appraisal is made and the economic condition then existing. Some appraisers state that existing net income of unfurnished apartments will be maintained until mid-life and then decline until the property loses its usefulness. This is not substantiated by the facts of the past thirty-five years. There are some who claim that it is impossible to estimate the upheavals resulting from wars and therefore it is necessary to adopt conventional patterns in our appraisal processes. However, values during the past twenty-seven years resulted from a post-war economy and today another war is in progress, costing ten times the cost of World War I, which will bring perhaps greater upheavals in our economy in the future. Modern appraising will prove meaningless if the appraiser is unable to protect the interests of both investor and mortgagee under conditions similar to those which existed in 1924. While appraising contemplates a spot value of a certain date, Value must represent the present worth of future returns which can be reasonably expected to result from every controlling influence. Actual future patterns instead of idealistic patterns are of vital concern to the mortgagee.

We have long held the opinion that the cyclic position and the probable actual future pattern at the time of making loans are of primary importance in mortgage lending. Upon actual future patterns of values depend mortgage patterns. A long-term, high percentage loan with small amortization would have been warranted in 1915 and 1933, while a short-term, low percentage loan with high amortization rates would have been necessary in 1920 and 1924. It is certain that FHA 90% loans would be unsound if made under conditions similar to those existing in 1924. It is understood that administration expense now takes about 50% of the insurance premiums and that the insurance reserve is about $1\frac{1}{2}\%$ of the insured liability. Under conditions similar to those existing in 1924 such a reserve would prove entirely inadequate. The 90% government insured loan for 40 years with interest at $3\frac{1}{2}\%$ advocated for the small home in the post-war period would prove unsound and an unwarranted subsidy which would tend to destroy values in existing residential properties. It should be opposed by those leaders whose interests are the conservation of real estate values.

From the table below, which gives the value of the dollar from 1913 to 1943 as measured by wholesale prices, it is apparent why the violent changes in the value of money which occurred during the past thirty years can warp and make meaningless any uniform pattern of the future behavior of real estate.

VALUE OF THE DOLLAR -- 1913=100
As Measured by Wholesale Prices

1913 - 100.0	1924 - 71.5	1935 - 87.5
1914 - 97.0	1925 - 67.6	1936 - 86.5
1915 - 95.2	1926 - 69.9	1937 - 81.0
1916 - 81.6	1927 - 73.5	1938 - 89.0
1917 - 59.5	1928 - 72.4	1939 - 90.9
1918 - 53.4	1929 - 73.5	1940 - 89.0
1919 - 50.5	1930 - 81.0	1941 - 80.0
1920 - 45.2	1931 - 95.4	1942 - 71.2
1921 - 71.5	1932 - 107.5	1943 - 67.8
1922 - 72.4	1933 - 106.0	
1923 - 69.4	1934 - 93.5	

A. B. Kissack
A. B. Kissack, M.A.I.

